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# America's Changing Investment Market

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THE AMERICAN ACADEMY of POLITICAL and SOCIAL SCIENCE
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# THE THEORY OF FOREIGN INVESTMENTS

By Edwin Walter Kemmerer,
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By the term theory of foreign investments we do not mean a congerie of unverified hypotheses concerning investments in foreign countries, but rather certain basic principles which represent the application of broad economic laws to a special field of economic activity.

## Basic Principles of Foreign and Domestic Investments the Same

The basic principles of foreign investments are essentially the same as those of home investments. The chief motive power that drives the machinery of both is financial profit. The principal criteria by which the goodness of a foreign investment is judged are the same as those by which a domestic investment is judged, *viz.*, income-yield, safety of principal, and marketability. In both markets the investor desiring these qualities must pay for them. If he wishes a high rate of income he must pay for it by sacrificing in safety or marketability or both; if he wishes a high degree of safety he must sacrifice in rate of income or marketability or both; and if he wishes a high degree of marketability he must sacrifice in one or both of the other qualities. Whether in the home market or the foreign one, each of these constituting qualities of a good investment has its own conditions of demand and supply. Sometimes one is in particular demand, *e.g.*, safety in times of business uncertainty, and sometimes another. The market price of each in terms of the other two in both markets is the resultant of the interaction of the forces of demand and supply, it is the price at which demand and supply in the particular market are equilibrated.

There is, however, a glamor about the word *foreign* which often blinds the eyes to the fundamental likeness of foreign investments and home investments; and, just as a few billion dollars' worth of foreign trade receives more newspaper headlines, editorials and political oratory than several hundred billion dollars' worth of domestic trade, so when American capitalists turn a few million

dollars into investments in Europe or Latin America, it is heralded as a great event, although the investment by these same capitalists of many times this amount in Texas, California or Alaska, places perhaps an equal or greater distance from our financial metropolis, is looked upon as commonplace. The word *foreign* is a political term, but the word *investment* is an economic one, and political boundaries do not obstruct the operation of economic law. Obviously there is not much difference in motive or in principle between the investment of a million dollars by a citizen of the United States in a paper factory in Ontario and one in New York. It is the likenesses, therefore, rather than the differences, that should be emphasized in comparing the principles of foreign investments with those of domestic investments. None the less, there are differences, and it is with them that we are chiefly concerned in this paper.

These differences may be subsumed under the heads: (a) "Internationally political"; (b) Monetary; (c) Social.

## "Internationally Political" Aspects of Foreign Investments

A factor of great importance in the study of foreign investments is international political rivalry. National territorial aggression has probably been a dominating factor in a far larger proportion of foreign investments than most people think. A little over a generation ago in Egypt, and more recently in Korea, China and Latin America, many millions of dollars were invested under conditions that seem explainable only by the motive of territorial aggrandizement on the part of the nation or nations whose citizens have made the investments. Recent history has shown that the steps are often short ones from private investments, say in railroad building, in weak countries by the nationals of strong countries, to spheres of influence for those strong countries with extra-territorial privileges; from spheres of influence to political control as regards foreign relations; and from political control in foreign affairs to political control in domestic affairs; thus bringing the aggrandizing nation into complete control of the weaker and once independent state. Sometimes private investors are the tools of the aggrandizing government, but more often probably the government uses private investments, which have been made by its nationals from purely economic motives, as an excuse for political usurpation.

## MONETARY DIFFERENCES BETWEEN FOREIGN AND DOMESTIC INVESTMENTS

A second difference between domestic investments and foreign ones relates to the currencies in which these investments are made and the monetary units in which their values are expressed. Domestic investments are usually made in the domestic standard of value and the domestic monetary unit, *e.g.*, the gold standard and the dollar in the United States, the silver standard and the peso in Honduras, and a fiduciary paper standard and the milreis in Brazil. Foreign investments, on the other hand, are often made in different standards of value, and are usually made in different monetary units, than those of the home country. This is not an essential difference between domestic and foreign investments, since in times of peace the great majority of the leading countries of the world are on the gold standard, and there are numerous instances in which several countries have the same monetary unit. The modern trend of foreign investments, however, is strongly in the direction of the less developed countries like those of Latin America and continental Asia, and most of these countries do not possess an established gold standard nor *de facto* monetary units identical with those of any of the more advanced countries.

Even in those cases, where the monetary standard in the country where the investments are being made is the same as that of the country from which the capital is coming, differences in the unit of value are to a small extent obstacles to the ready flow of capital. Foreign units, like the bolivar of Venezuela or the colon of Costa Rica, even when on a gold basis, speak a foreign language. The capitalist can translate it by an effort, but it is not a language in which he thinks. He can mathematically compute the equivalents in terms of his own money, but he does not feel them when prices are quoted.

This difficulty, however, is a small one compared with the one arising from differences in the standard of value itself. The wide fluctuations in the gold value of silver during recent years, *e.g.*, 33 per cent in 1907 and nearly 40 per cent so far in 1916 (*i.e.*, to September 15), are familiar to students of economics, likewise the even greater fluctuations in the paper-money units of fiduciary-standard countries. When the gold value of a silver-standard peso or of a fiduciary-standard milreis depreciates, say, 20 per cent as measured

by foreign exchange rates, it does not mean that local prices in terms of silver or paper-money units will at the same time rise 20 per cent. Price changes respond very slowly, and sometimes imperceptibly, if at all, to changes in the gold values of the monetary units of countries not on a gold standard. Short-time fluctuations in the gold values of these units have little or no effect on local prices, and the long-time swings make their influence felt on the prices of the majority of goods very slowly. This fact is of great significance to the foreign investor.

From the standpoint of the currency problem, foreign investments divide themselves into two classes; in the first class the investor becomes a proprietor, in the second, a creditor.

The "proprietor investments" are represented by the ownership of stocks in foreign corporations and by individual or partnership ownership of unincorporated enterprises. In these cases profits are realized and paid in the foreign money, and upon the shoulders of the foreign investor are placed the risks incident to a fluctuating exchange. When, for example, the gold value of the foreign unit, say the haikwan tael of China, rises, the American investor receives more United States dollars for each 100 taels of profit; when it falls, he receives less. If it falls heavily and he wants to sell out and withdraw his capital, he is likely to find that the market price of his property in terms of silver has not risen anything like so rapidly as the gold value of the tael has fallen and that, so far as gold values are concerned, he must sell at a sacrifice. On the other hand, if silver rises rapidly he may realize a net gain because the local value of his property is not likely to decline in proportion to the advance in the gold value of the tael. For this reason proprietorship investments in silver-standard and fiduciary-standard countries impose large speculative risks on the foreign investor—risks which must be compensated for by prospects of attractive profits.

In the second class of foreign investments the investor becomes a lender. He advances a sum of money in return for a promise from the borrower to pay back the principal at the end of a specified period—sometimes there is no specific maturity mentioned—and to pay a definite rate of interest at regular intervals. The best examples of this second class of investments are corporation and government bonds. Investments of this class may be made payable:

(1) in local currency, or (2) in a foreign currency, usually in the gold-standard currency of an important foreign country. In the former case the risks due to fluctuations in the gold value of the local monetary unit fall upon the foreign investor, as in the case of the proprietorship investments. In the second case, however, as for example when the investor buys corporate bonds that are payable principal and interest in pounds sterling or United States dollars, the immediate risks incident to the fluctuations in exchange are shifted to the local borrower, *i.e.*, the corporation or, more narrowly, the owners of the corporation stock. I say the *immediate* risk is shifted to the stockholders, for even here the bondholders do not escape entirely, since a substantial depreciation in the local monetary unit is likely to lessen the gold value of the plant which is security for the bonds, and may also lessen the gold value of the corporation's products, especially if they are sold to a large extent locally, for, as we have seen, local prices do not advance at once proportionately to the depreciation in the gold value of the local monetary unit.[1]

## SOCIAL DIFFERENCES BETWEEN DOMESTIC AND FOREIGN INVESTMENTS

The third important class of differences between a domestic investment and a foreign one we have called (for want of a better name) social differences. These are of a miscellaneous character, and it will be sufficient merely to mention them. There is the difference of language, which is often an impediment to the ready flow of capital from the cheaper to the dearer market, through preventing a thorough knowledge of foreign conditions and leading to annoying misunderstandings in the negotiation of capital contracts and the conduct of current business. Then there are unfamiliar systems of government, of jurisprudence, and of taxation; and there are business, political and social customs which are difficult for the

[1]If the products are sold largely in gold-standard countries the depreciation of the local monetary unit may increase the corporation's profits and, through their capitalization, even the gold value of the plant itself, because the corporation will receive more local units, *e.g.*, taels, pesos, or milras, for each foreign unit obtained for its products, while local expenses, especially wages, will be constant or at least rise slowly. Of course the situation would be the opposite in case the local monetary unit appreciated in value.

foreigner to understand—all of which serve as barriers to keep capital from flowing into foreign fields.

It is only when the attractiveness of large immediate or future returns becomes great enough to surmount these barriers in addition to overcoming the natural conservatism of capitalists who prefer to see where their money is working, that capital moves out of the home-land for permanent investment abroad.

### How Capital Reaches the Foreign Field

Superficially viewed, capital is transferred from one country to another chiefly by the mechanism of bank drafts and commercial bills of exchange. Such credit instruments, however, obviously do little more than transfer ownership of capital goods already located in the country in which the foreign capital is being invested, or of goods about to be shipped to that country. The credit instruments are evidences of an outward movement of more substantial things which constitute the real investment. These substantial things may be divided into three groups: (1) merchandise (using that term in its broad sense); (2) services; (3) international money.

*Merchandise.* The investment of foreign capital in undeveloped countries usually means the building and equipment of railroads and factories, and the opening up of various kinds of plantations and mines.

Much of the capital equipment for these enterprises must come from abroad. Inasmuch as the investing capitalists are most familiar with the products of their own country, are naturally prejudiced in favor of their own nationals, and are often themselves directly or indirectly interested in the production of the capital goods needed abroad, they will usually buy this capital equipment in their own home markets rather than abroad, if they can do so at anything like as favorable prices—a fact which is largely responsible for the slogan "trade follows the investment." This is true whether the investment is a proprietorship investment (such as the purchase of corporation stock or of an individual or partnership interest in an unincorporated business) or a creditor investment, *i.e.*, a loan (such as the purchase of bonds, debentures and the like). In the former case the investor may exercise direct control over the purchase of equipment through the power to vote the stock or otherwise to manage the business. In the latter case he exercises an indirect

control, but often a very effective one, through the pressure that investors and particularly investment bankers nowadays exercise over concerns in which they are interested. The principal form then in which foreign capital is transferred to a new field is through the exportation of capital goods to that field, and this may be directly from the investing capitalist's own country or indirectly through the mediation of trade with one or more other countries. There are strong forces, however, which tend to cause the capital goods to be shipped directly from the country of the investing capitalists. New countries in process of development, usually for a long time, therefore, show a heavy excess of merchandise imports over exports, an excess which consists chiefly of foreign capital in process of investment.

*Services.* The second form in which transfers of capital are made is that of services. Here the goods exported are of an immaterial kind and do not figure in trade statistics. They include such items as the services of engineers, chemists and financial experts, who are sent out to do pioneer work in the planning and development of the new enterprises, and whose services often represent an important part of the new capital investment. Under this head also come the value of the transportation services in shipping the capital goods, marine-insurance services rendered by concerns outside of the importing country, and similarly legal and financial services. These services of course may be furnished by the concerns of other countries than that of the investing capitalists through a triangular (or even quadrangular) trade, country A shipping goods or rendering services to country B in compensation for services country B renders to country C, but, as in the case of the transfer of capital goods, there are forces which strongly encourage the securing of these services from the nationals of the investing capitalists.

*International money.* The third form in which foreign capital is transferred to a country is international money, *i.e.*, gold bullion and gold coins (usually by weight) and, to a limited extent, silver bullion and certain silver coins with an international circulation like the Mexican and British dollars. Strictly speaking, money is a form of merchandise, and is exported for the same reasons that any other merchandise is exported, *i.e.*, because a certain quantity of it is more valuable abroad than it is at home by enough to pay shipping

expenses and yield an adequate profit. But international money is the most highly marketable of all kinds of merchandise, and this high degree of marketability makes it the great equilibrator in international trade movements, *i.e.*, an article whose shipment "pays trade balances," and is particularly useful in helping maintain a world equilibrium of prices.

The exportation to a new country of capital goods and capital services for investment, and the contemporaneous development of new enterprises causes an expansion of business in the country receiving the capital and an increased demand for media of exchange. Temporarily this may be met by a straining of credit, and, to some extent, by a more rapid turnover of bank deposits and of money in circulation. The demands, however, for additional media of exchange to carry on the country's growing business soon make themselves felt in inadequate bank reserves, insufficiency of loanable bank funds, higher interest rates on short-time loans, and a downward tendency in the prices of the more sensitive securities and commodities; exchange moves to the gold (or silver) import point, and enough international money is imported to bring the country's credit and currency circulation up to the amount necessary to carry on, without undue financial strain, its expanded business, at a price level which is in equilibrium with those of the other countries of the world.

## Capital Investment and Trade

This investment flow of foreign merchandise, services and international money may continue for many years. During all this time the country in which the foreign investments are being made—we need an expression "investee country"—carries on its regular import and export trade. But its visible imports continually exceed its visible exports, and this excess consists largely of the foreign capital being invested in the country. The foreign capitalists take their pay in titles to ownership (*e.g.*, stocks and deeds) of this foreign property, or in liens on the property (*e.g.*, bonds and debentures) from all of which they expect to receive sooner or later a regular income.

When the income is realized it may be brought home or left abroad and reinvested. To the extent that it is brought home it tends to turn the balance of trade against the "investee country," for the interest, dividend and other profit payments on capital

invested are paid back chiefly in the form of merchandise exports. In so far as these profits are not brought home but are reinvested abroad they serve to build up still further the foreign capital equipment of the "investee country." Sooner or later, however, the foreign investor expects to bring home his profits. The periodic return to the investor of profits realized abroad and the return from time to time of parts of the capital fund in the course of time offset the amounts of new foreign capital being invested and cause the country's visible exports to exceed continually its visible imports, thus compensating for the heavy excess of imports which characterized the period of the original foreign investments.

The investment then of foreign capital, the payment of profits realized upon that capital and the repayment of the principal either gradually or in lump sum, are effected through the mechanism of the export and import trade, the chief item of which is the movement of merchandise. Trade follows the investment, and the flow of investment capital together with the return flow of investment profits are substantial items in the foreign trade of an economically new country.

## THE PROSPECTS FOR ECONOMIC INTERNATIONALISM

By William English Walling

The French and British governments have solemnly bound themselves to put into effect the program for a trade war elaborated by the Entente Economic Conference. The American press is unanimously against the new policy even after it is too late to protest. Some papers profess to find it too mad for belief. Others plan retaliation, and even suggest—in case it is actually carried out—an economic alliance with Germany.

It is a condition and not a theory that confronts us. The Entente statesmen have declared that their purpose is the economic defense of the Entente, the economic independence of the world, to employ an expression of one of the three British delegates, Hughes of Australia. And it is certain that the proposal of an economic alliance of Germany and Austria and Central Europe gained the adhesion of the leading parties of Germany before the similar plan of the Entente powers had secured the support of public opinion in Great Britain. But while Germany has begun to draw back at the prospect that she might get the worst of such an economic war, the idea had obtained a constantly increasing popularity in Great Britain for the same reason. Von Gwinner, President of the Deutsche Bank, confesses that "the one thing that Germany's highly developed industry cannot stand is that we should, by granting one-sided preferences to our friends, quarrel with the whole world." Indeed the German Minister of the Interior, Von Jagow, has practically admitted that Germany would be beaten in a purely economic struggle, when he says that Germany will not lay down her arms until the Entente has conceded her the same economic position as she held before the war.

To this demand for a return to the economic *status quo* the French have made the following answer: It was Germany which forced upon France in 1871—by her military superiority—the "most favored nation clause." This clause forbids France to make either the tariff treaties and economic alliances which are to her economic interest or those which might strengthen her military position. Thus

France was for forty-three years, to this degree, economically dependent upon Germany. She now declares her economic independence.

### 1. The War After The War

The responsibility for "the war after the war" may then be placed on the shoulders of either group of belligerents. It is like the question of the responsibility for the war of fleets and armies; the problem is too complicated for a satisfactory and simple answer, and at the present moment it has become of secondary importance. For the Entente is preparing for the coming economic war as systematically and relentlessly as the central powers prepared for the military conflict.

Whether we like it or not we are involved in this economic "war." Surely the greatest and most practical nation in the world will henceforth confine its attention to this overshadowing fact. Until the new world war was actually declared, there was still some excuse for our protest that we opposed it. That position may have been due to a blind and selfish nationalism or to ignorance or indifference as regards world affairs; it may have been incredibly impractical in view of the fact that there was no practical reason why the Entente should not undertake this kind of war against its enemies and no practical means by which the United States could prevent, deter, or even moderate such action. Still as long as the new war had not been declared we might please ourselves with the hope that it would not be. That hope cost us nothing more than our state of mental unreadiness to meet the issue when it was presented. We refused to face the situation until it was completely developed. We must face it now.

The phrase, "the war after the war," implies not only that the military war will have been finished, but that another war is to be added to it. On the contrary the only ground upon which the economic "war" was or could have been suggested was that it will act largely as a substitute for military war. The longer the military struggle the shorter the economic struggle and vice versa. Indeed this fact is recognized by the Paris correspondent of such a consistent low tariff paper as *The New York Evening Post,* which points out that the economic conferences of the Allies may help "to neutralize the aggressiveness of Germany which *otherwise* might lead to a new war after a few years of peace." The correspondent continues:

"That an economic war of some kind is bound to prolong the war of soldiers and guns, nobody in his senses can deny. This was the inevitable risk of war and Germany took the risk." He says that Americans should remember that Germany had secured by treaties (partly compelled by war or the threat of war) a position "favored and privileged above that of the United States."

Nor is the new policy of the Entente in reality an economic war —except in the figurative sense in which all competition is war. In this sense most of the industry of each nation is in a state of war, and every nation is at present in economic war against every other nation. In competition one does not necessarily aim, even gradually, to reduce one's rival to relative impotence, though competition does often lead to economic war in this sense, especially when the stage of great combinations is reached. Perhaps this is the ultimate stage in all private industry. But if we do decide to call the economic competition of nations economic war, if we declare with a *New York Times* editorial that "the world has not yet advanced beyond the stage of war in economics," then we cannot avoid two conclusions with regard to the new policy of the Entente. We must admit that the "war after the war" is on no different fundamental footing than "the war before the war." And we must admit also that the proposed mutual lowering of tariffs within the Entente may conceivably mean an increase in the area and degree of trade-peace greater than the proposed increase of this previously existing trade-war with the central powers. The economic prosperity of the United States is acknowledged to be largely due to the non-existence of tariff walls within our vast area; the success of the present German Empire was largely due to the preceding Zollverein. Yet Herr Ballin, Director of the Hamburg American Line, says that one of the main objects of Germany in the present war is to prevent the British Empire from adopting a policy of preferential tariffs, and hitherto most Americans have seemed to sympathize with him.

Let us admit that the world has hitherto been in a state of permanent economic war. Few practical statesmen would deny that it is this war chiefly, if not almost exclusively, that has produced military conflicts. We must aim above all, then, at economic peace. Is it surprising that the chief means of attaining this peace, and the steps by which it is to be reached, are proving to be more and more of an economic order? Even military war now rests

more upon industrial power than upon numbers of men or purely military organization. Is it not the natural course of world evolution that economic war should gradually replace military war altogether—even as a means of compelling the minority of the nations to accept the plans of the majority as to international economic relations and world organization?

In one sense, and one sense only, is the new policy strictly comparable to war. It does *not* aim to set up an economic balance of power, nor at two permanent hostile alliances. It has a definite object, the same as the object of the present war. It proposes to compel the minority among the nations to enter into the new combination, to accept the will of the present majority as to boundaries, and the will of a future and constantly changing majority as to all other economic questions. Like the American trusts, it does not aim to destroy its rivals, but tends to force them to come into the combination, not at their own figure, but at a figure that yields a handsome profit all round.

But it is not to be a policy directed primarily against any nation. An Entente arrangement "for fostering trade among themselves" that results "to the disadvantage of Germany" (the excellent characterization of *The New Republic*) combined with a similar arrangement of the Central powers does not amount to "a mutual boycott," as the correspondent of the Associated Press states. This correspondent answers himself when he says that while an actual "war after the war" may not eventuate, "statesmen in both European groups are discussing how they may use treaties and tariffs to get the upper hand in commerce" and he refers to the Germanic powers as having taken the initiative in this activity with their proposed Central European Zollverein. *The New York Evening Post* also remarks editorially that the Entente plan "strikes a note of mutual aid rather than injury to the common enemy." But the mutual aid of a limited group *under conditions of competition between nations* means the *relative* loss of those nations outside the new alliance.

The equally staunch British organ of low tariffs, *The Manchester Guardian*, is more constructive. It urges that Germany also must be admitted into the "union of nations" as soon as her people "give up their faith in war and agree to work with other nations for world peace and for the common good of all." The very object of

the new combination is to bring Germany to realize this necessity. But *The Guardian* realizes that this may require some time. It continues:

> A union of States is to be set up against another union of States. Such proposals challenge our enemies to continue an economic war after this war is finished. If Germany shows no repentance for her plot against the world's freedom; if she manifests no change of mood, then this painful thing might have to be. If Germany uses her commercialism as the cat's paw of her militarism, then we must fight her commercialism, for the whole spawn of militarism is poisoned with the evil of its origin. So if the German nation were sullen after this war over being beaten, but not convinced of the wrong of militarism, and if the nations set out to prepare for a permanent war, why, then such proposals might become necessary.

*The Guardian* is a free trade organ and advocates the proposed tariff union exclusively as an emergency measure. But the new policy is also the result of a natural evolution. Suppose Great Britain enacted a tariff about half as high as those of Germany and the United States. Would this constitute an indefensible trade war? Suppose she then secured, by reciprocal treaties, reductions—as far as she is concerned—of the tariffs of Canada and Australia, and also of France and other allies. Certainly that would not be an increase of trade warfare. Suppose she used the same means to secure a reduction of American and other neutral tariffs against her. Would not the total result be a net reduction from the present tariff levels?

The key to the whole situation lies in the fact that Great Britain is the only important free trade nation. All the other great powers are not only protectionist but have very high tariffs. Therefore, by temporarily abandoning her free trade principle she has something to offer all nations. If she uses this advantage for any other purpose than to secure a reduction of their tariffs, the total world result will be a reaction towards a net intensification of existing trade wars. But if she uses it exclusively to secure tariff reductions there will be a net gain for trade peace, provided she enters into reciprocity treaties with nations having the larger part of the world's trade. Now the foreign trade of Great Britain's colonies and allies is far greater than the foreign trade of Germany and Austria. And this is natural since the Entente has considerably more than twice the wealth, income, and industrial power of the Germanic powers,

several times their population and many times their land area—to say nothing of the Entente's commercial predominance at sea.

But it will be to the interest of Great Britain to enter into reciprocity treaties with the neutrals also, especially the United States—and all the plans of the new economic union provide for such a policy. It would, furthermore, pay Great Britain, *if she were a separate unit*, to enter into a tariff treaty with Germany. If such a treaty seems at present unlikely it is because Germany herself, as well as Great Britain's allies, would probably not consent to very radical reductions.

But while Great Britain has this choice of action with all the nations, the high tariff nations, whether British colonies, France, Germany, or the United States, do not have any such option as to tariffs among themselves. These countries have already put their tariffs as low as they believe their national economic interests permit. They have reduced these tariffs by treaty whenever the ruling economic classes felt they could secure a corresponding advantage. Germany cannot retaliate against England except at her own cost, nor can the United States. Germany and the United States cannot enter into a radically different treaty with one another in order to satisfy a spirit of revenge against England without paying a heavy price. For they have already reduced their tariffs wherever it has paid their ruling classes to do so. Germany might be willing to make the sacrifice demanded in order to injure a military enemy. The United States will scarcely go beyond a business view of the situation.

Nor would the United States be content to rest long in a condition of economic isolation. In this war Great Britain and Germany have both recognized that military and naval isolation is no longer feasible, and all American students of international affairs have learned the lesson. The new international economic groupings, no matter how partially and incompletely their union is worked out, show that the day of relative economic isolation, of national self-sufficiency, is also past. Who doubts the quickening, as a result of this war, of the economic interdependence of the component parts of the British Empire, of Germany and Austria, of Great Britain, France, and Italy? It is true that the United States has the wealth and position to remain independent for a certain period, but only at a high cost, at the risk of falling into an inferior position, and by

endeavoring to hold the economic balance of power between the two groups and using its position for its own aggrandizement without regard to the effect of this policy in keeping alive the danger of another world war. But such an aggressive international policy will not long be profitable for America after the new economic union gets into working order. And if America can see that far ahead, why can we not see also that it is to our national interest to promote this economic league to enforce peace *now* and to do our part in setting at work forces that will ultimately put an end to the present dangerous and costly organization of the economic world on a predominantly national scale?

German public men, apparently without an important exception, outside of the small group of extreme Socialists, desire to see the economic world remain divided into antagonistic national units *unless*—or, as the extremists put it, *until*—Germany is able to exercise a share of world power at least equal to all other nations combined. Even majority Socialists, like Quessel, advocate national self-sufficiency as against international interdependence. But the nation that pursues the policy of economic nationalism and continues to pursue it, is bound to retrogress *relatively*. And when the German economist avows this policy he surrenders his right of complaint against the protective measures of the other nations. Economic nationalism is the cause of Germany's failure—in so far as there has been a failure.

Great Britain, on the contrary, is the classic land of international finance. She has more money invested in the United States than in her next most profitable field, Canada—which is almost as independent politically as the United States—and she has nearly four times as much in Canada and other self-governing colonies as in crown colonies like India. She has almost as much invested in South America as in Canada, and similar proportions applied to her annual investments right up to the present war. Privileges and concessions undoubtedly exist that are based upon her colonial and naval power, but they evidently account for only a very small part of her income from foreign investments.

The proportion of British *trade* due to special national privileges was notoriously even less than the proportion of her *investments* due to this cause. Moreover, she was absorbing a constantly and decidedly smaller proportion of the trade of her own colonies from

year to year, while Germany's world trade was increasing more rapidly than England's, even though there was no probability that she would replace the latter in the British colonies.

The same general tendencies apply to France also. France retains very important tariff privileges as well as investment privileges with her colonies. Yet French investments in Russia were many times more important than her investments in all her colonies put together. Germany, Russia's neighbor, her chief customer and provider, was certainly at liberty to fill the position taken by France and without making Russia a political colony. But she preferred a hostile attitude as shown by her tariff treaty with Russia. Similarly even the Belgians were deeply interested in the great British and French railway syndicates of China. If Germany had surplus capital, and had accepted the position of minor stockholder (like Belgium) she would doubtless have been welcome there. Yet the deliberate intention of her dominant capitalists not to enter into international finance as individuals, but only as a nation, led her to slight all these opportunities.

A similiar situation exists as to international trade. German economists, not satisfied with complaining of the free trade or low tariffs between England and France and their colonies, also complain of the similar policy of Russia with her new territorial acquirements, which are contiguous, and so part and parcel of the country. They might as well protest against the greater free trade area of the United States—or the superior climate of Australia.

## 2. An Economic League to Enforce Peace

Permanent peace requires a certain degree of world organization. The degree of organization needed to make war altogether impossible will not be attainable at a single step. And it is further recognized that, no matter how incomplete the first step may be, it will probably fail to secure the endorsement of all the nations during a certain transition period. A bare majority of nations would not constitute a sufficient force even to begin with any of these plans. But a considerable majority, including nations that represent say two-thirds of the world's industrial and military power, would be quite sufficient. Even a somewhat smaller proportion might suffice, as part of the nations remaining outside might be in no way hostile to the dominant combination, but only too weak to feel able to make

their financial contribution to its world program or to be certain of enjoying a full share of its benefits.

The final aim of all peace plans is and must be complete world organization. In every plan a negative automatic pressure is to be exerted on all outside nations to draw them in. And in case a hostile nation or group of nations aims to break up the dominant combination, this pressure becomes positive.

Sea power is by its very nature indivisible; a nation or group of nations which controls any considerable part of the sea controls it all. Therefore, as international organization develops it will almost of necessity gain the support of the sea powers before it has the support of the land powers. The sole important economic function of the sea is to serve as an international trade route, while this is only a secondary economic function of the land. The development of sea-trade tends to tie the sea powers together, land interests keep the land powers apart (except as they unite temporarily the better to wage war). The half-way step to the internationalization of all international trade routes must thus be the predominance of sea powers, and not of land powers.

A sufficient volume of international trade would so bind the nations together as to make war highly improbable. Indeed they would soon become so interdependent economically as to make it almost impossible. This end would be secured by a world-wide system of reciprocal tariff treaties. H. N. Brailsford, one of the leading British pacifists, in his last book, reaches the conclusion that peace can be made secure only by such a Zollverein. But suppose that the central powers, representing less than one-sixth of the world's trade and hardly a fifth of the world's wealth, income and productive ability refuse to enter into such a Zollverein, unless on terms unacceptable to the other powers. Should its formation be indefinitely postponed, or should it not be hastened by the fact that automatic economic pressure would then force the minority parties all the sooner to enter into the combination?

Another promising recommendation of the Allies' economic conference is international governmental action "for the establishment of direct and rapid services of transportation by land and sea at reduced rates." The war has already brought a high degree of international operation of the shipping of the Entente. This new policy would be a first step in international government ownership

or international state socialism. All outside powers would suffer negatively from such a powerful shipping combination. But would it not be the first step towards a world-wide organization of shipping?

If a League to Enforce Peace ever comes into existence at all it will be an Economic League. Along purely political lines such an international organization is altogether impracticable. Any definite political organization would at once bring up the insoluble question of relative voting power. Is Montenegro to have one vote, the same as Russia or France? The question proved to be insoluble at the Hague and authorities like John Bassett Moore believe it to be permanently insoluble. Yet the problem cannot be avoided. The cost of an international police or national armaments held in readiness for international use, would have to be distributed. And many other equally difficult international economic problems would have to be faced.

Such international organization is unthinkable unless sufficient economic unity is already present among the combined nations to assure a common attitude on the most vital issues. Moreover, where an opposition did exist on a vital issue means would have to be at hand for exerting a pressure to prevent secession. Some day international trade may have so developed as to bring about the necessary degree of unity among a large part of the nations and to furnish the means of restraining seceding minorities. But international trade has not reached that point today, unless between the United States and Canada, and between Germany and Austria and their smaller neighbors.

However, there is another unifying economic force, international investment. Great Britain has invested a fifth of her wealth in foreign lands. If we add to this her shipping and shipbuilding interests and the expenditures of colonists and foreigners visiting or residing in Great Britain, a very large part of her income is due to foreign investment. France is in a similar situation, and many other nations are deeply involved, either as borrowers or lenders, in the web of international finance. In so far as governments are the expression of financial interests of this character, none of the problems of a widespread international economic league need prove insoluble. The financiers of the smaller nations would maintain the same attitude to those of London and Paris as in private affairs at the present time. Provided they are guaranteed an approxi-

mately just share in the profits, they yield control to the larger financial powers. An international conference of financiers, already engaged in common undertakings of a private character and mutually interdependent, would manage to reach compromises where a conference of diplomatists would reach a deadlock.

If a League to Enforce Peace comes into existence, it will be a league that concerns itself from the first with constructive economic problems and not merely with international law, justice, or morality. It will be neither judicial nor legislative but administrative in the sense that financiers administer a nation's industry. International governmental conferences directly or indirectly controlled by financiers would be as far as possible from leaving the economic or political organization of the world in the *statu quo ante*. They would respond at once to the change in economic conditions and relations due to the constant development of new forms of transportation and new trade routes, the discovery of new resources and new industrial processes and the appearance of new human needs. Nor need they represent large capital alone. In France, some of the great banks, under governmental control, try with a certain measure of success to serve the small investor, and the same is true of several other countries where middle-class governments are powerful. Financial plunder continues, but the proportion of the total capital of the country that goes in this way is relatively small. And finally, when the governmental control reaches the point it has attained in Australia, even the interests of the small farmer and artizan are consulted.

A League to Enforce Peace, if controlled by such financial interests and economic purposes, would assume a business-like attitude and not an attitude of hostility to nations outside the League. It would endeavor to bring the other nations into the combination, to the greater profit of both parties—just as the great industrial combinations did with their rivals. For this purpose it would always find economic pressure more economical than military force—unless the outside powers become exceptionally aggressive or menacing.

The United States Chambers of Commerce have already endorsed the League to Enforce Peace and the use of economic pressure, where possible, as a substitute for war. They are in favor of a boycott against any nation that "goes to war" without arbitration. Such

an improvised boycott would not only be too late to be effective, it would also be impossible of execution. As the opposition in the chambers of commerce pointed out, the cost of a boycott would almost certainly fall more on one nation of the league than on another, and the more burdened nation would refuse its consent. If, in quiet periods, when there is plenty of time and no crisis is at hand, it is so difficult to arrange a reciprocity treaty between two countries, how much more difficult it would be to arrange an international boycott in an emergency. Moreover such a boycott would be applied only for a relatively short time and at the moment when it would be least effective against the aggressive nation, already entered on its wayward course. To be effective, economic pressure must be applied steadily, systematically, and throughout a long period. It need not go by as far as a boycott in the methods employed, but it must go further than a boycott in its objective. It must aim, not merely to enforce the will of the great majority of nations in an emergency, but to compel the definite acceptance of the principle of majority rule.

As soon as the league succeeds in establishing majority rule among the nations—in fact in order to reach this point—it must proceed in the direction of removing the economic causes of war. It must make partial world arrangements as to trade routes and shipping and a partial series of reciprocal tariff treaties. This is not trade war, except incidentally. It is rather a lessening of trade war and a gradual enlargement of the areas of trade peace, a process which is the prime fact in all economic history, the chief secret of the success of Germany and the United States, as well as the British Empire. The enlargement of trade areas, like the enlargement of industrial units, is the very measure of progress, and is widely accepted as such.

This system of international reciprocity treaties, embracing trade with one nation after another until gradually all foreign trade is included, is equally remote both from free trade and from protection along national lines. Yet the principle of reciprocity is already accepted by a majority in both high and low tariff camps. The opposition comes not from finance, capital, or business as a whole, but from particular interests which are operated on the basis of the practical prohibition of imports at the cost of other industries which might develop exports far more profitable to the business of the home country considered as a whole. Before the war these parasitic

interests were so entrenched that there was little hope of uprooting them, even in order to secure valuable new markets. But now Great Britain will compel us to reconsider the whole reciprocity question. And surely in reaching a decision we shall consider the fact that the future peace of the world is also at stake. Even aside from the cost of a possible war or preparation for a war in which we ourselves may be involved, the certain disturbance of world trade from another world struggle should have some weight.

The issue is clear—it is economic nationalism against economic internationalism. Is the United States to aim solely to increase its economic self-sufficiency, or is it to enter consciously into the path that leads towards the economic interdependence of nations, the increase of the dependence of other nations on the United States and of the dependence of the United States on other nations? Up to the present there has been a steady if slow gain of interdependence throughout the world, especially during the last century—which marks the rise of modern science, industry and democracy. In spite of the efforts of Germany, France, and other nations, this beneficent economic tendency continued even after 1870. Shall the United States further this tendency? Shall it set its face towards the future by adopting a policy of economic internationalism as fast as conditions permit? Or shall it set its face towards the eighteenth goal of economic self-sufficiency?

# BRITISH OVERSEA INVESTMENTS, THEIR GROWTH AND IMPORTANCE

By C. K. Hobson,

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In the great European struggle, it may well be that the financial resources of Great Britain are destined to play a decisive part. The magnitude of the economic efforts which have been put forth by the British people is generally recognized. It may be recalled that within two years, means have been discovered to organize and fully equip a new army numbering millions of men; while at the same time the foundations of British power at sea have been greatly strengthened; and in addition it has been found possible to place at the disposal of the Allied governments gigantic sums for the purchase of munitions and warlike stores. An official estimate puts the amount of loans and advances by Great Britain to the Allies at no less than £1,500,000 daily on an average during the current financial year. Who can doubt that this financial assistance has been of inestimable service to the Allied cause? It is clear, for example, that the recovery of Russia after her prolonged misfortunes in the summer of 1915 was greatly facilitated by British assistance in the provision of military equipment. Again, it is largely British finance that has enabled the Belgian and Serbian armies to remain in the field as an effective military force.

### Great Britain's Aid to Her Allies

The financial assistance that Great Britain has rendered to the Allied governments, has largely taken the form of paying for their external purchases. It is true indeed that vast quantities of munitions and equipment have been manufactured in the United Kingdom and exported to France, Russia and other Allied countries at the cost of the British government. On the other hand, the Allied governments have desired to obtain large quantities of ammunition, arms and supplies in other countries, *e. g.*, in America or in Japan, and have in many cases called upon Great Britain to meet the cost of these purchases. This has been one of the most difficult problems which British finance has had to meet. France and Russia

have, it is true, obtained loans in America and elsewhere, and to that extent the financing of purchases which they were themselves unable to pay for at the moment has been shifted onto shoulders other than those of the British government. It has, however, rested with the British government to finance a very great amount of the foreign purchases made by the Allied governments. Great Britain has been in a position to do this largely in consequence of the enormous quantities of capital which she has loaned to the citizens and governments of foreign countries, or invested in British companies carrying on business abroad, in years gone by. She has been able to call in foreign credits and maturing obligations and to realize by sale or by using them as *collateral* for loans, vast amounts of American and other securities which have been accumulated in time of peace.

Never has the magnitude of the financial pull which London has become able to exercise over the rest of the world been so clearly manifested as during the present upheaval. The mere threat of war was sufficient to cause all the foreign exchanges to move violently in favor of London, and the machinery of payments broke down because a crowd of foreign borrowers was trying to transmit money to London in payment of obligations falling due, and scarcely anybody was trying to transmit money the other way. The vast purchases of stores and munitions which had to be paid for, both on account of the British war services and on behalf of the Allies, coupled with a great falling off in the export trade from the United Kingdom, caused the foreign exchanges to move gradually against Great Britain soon after the outbreak of war. But even after two years of war, during which hundreds of millions sterling have been withdrawn or borrowed from abroad and lent to the Allies, the foreign exchanges on London are much nearer to the normal than are the exchanges of any other belligerent country. This is a clear testimony to the substance and credit of the British nation. The task of finding so many millions to make payments abroad has, however, proved no easy one. The British government has had to act boldly and drastically, especially in connection with the schemes for mobilizing American and other foreign securities. On the whole, however, it is probable that the limits of the Allied purchases abroad have hitherto been fixed rather by shortage in the supply of goods and equipment of the kinds required than by inability to foot the bill.

This rough estimate of the value of British foreign investments to the British nation, and to the Allied cause generally, during the present war, is given by way of introduction to what is the main purpose of this article, namely a discussion of the nature of British investments [1] prior to the war, of their growth, distribution and extent.

## Early British Investments

British foreign investments have been built up gradually and somewhat unostentatiously during a century past. It is hard to fix a date at which foreign investment began, for traces may be found in the sixteenth and seventeenth centuries and even earlier. The sums involved, however, were very small according to modern notions, and the same was true even in the eighteenth century. A considerable capital was indeed represented in the East India Company, and investment in the West Indian plantations and in the American colonies attained a certain importance. It appears probable, however, that during the eighteenth century Great Britain was on balance a debtor rather than a creditor country. The demand for capital which accompanied the industrial revolution, and the large government borrowings necessitated by prolonged wars, attracted to Great Britain a considerable amount of Dutch capital for investment in the national debt, in Bank of England stock, and in other enterprises.

The commencement of a rapid development of British foreign investments may be dated at the year 1815. During the Napoleonic wars, very little had been done in the direction of extending foreign investments. Accumulations of capital were absorbed in financing the war; in paying subsidies, amounting altogether to some £46,000,000 in cash, exclusive of a large amount supplied in kind, to continental allies; and to some extent in industrial development at home. When the war stopped, surplus energy found vent in a marked extension of British investments abroad and a reduction of foreign investments in Great Britain. Large loans were made to impoverished continental governments, while considerable foreign holdings of British stocks were bought back from Dutchmen and others. A big boom, culminating in 1825, was characterized by speculation in every kind of foreign venture, conspicuous among them being South American mines and South American government

[1] A fuller account is given in my book, *The Export of Capital*. (Constable) 1914.

loans. During this period, too, there was apparently some investment in United States bonds; and at a somewhat later date substantial amounts of American canal, state and railway bonds began to be bought by British investors. The advent of the railway indeed opened up a new era to the investor, and from the '30's onwards large and increasing sums were placed by British investors in American railways. Some companies, indeed, were controlled from the beginning by British capital. Rails and materials were to a large extent sent from Great Britain, payment being made in bonds. In Europe, British capital also became actively engaged in the establishment of manufacturing industries, and later, in construction of railways, many of the Belgian and French lines being largely financed in London.

These two fields of investment, the United States and Europe, took for a time the great bulk of British capital invested abroad. Other outlets, however, gradually increased in importance. Investment on the continent of Europe was on occasions checked by political considerations, notably by the disturbances of 1848; and at a later date the growing wealth of France and other continental countries led British investors to seek more profitable openings for their capital elsewhere. America continued to provide attractive openings for British capital, although the amount invested fluctuated according to industrial and commercial circumstances from year to year, and the outbreak of the Civil War gave a set back to investment from which it took some years to recover. The British colonies, including Canada, Australia and India, began to attract more of the investor's attention, and at a somewhat later date South America, South Africa and the Far East became prominent as fields for investment.

### VARIATIONS IN THE AMOUNT AND NATURE OF INVESTMENTS

Capital flowed out, on the whole in increasing quantities, in spite of great variations from year to year. Scarcely ever did a year pass, without some addition being made to the quantity of British investments abroad. One of the few exceptions was during the early '70's. For two or three years British holdings of capital abroad appear to have been actually diminished, by withdrawal of capital. This was during the period of depression which followed the boom of 1872–3. That boom had been preceded and

accompanied by vast issues of foreign government loans and of all kinds of other bonds and shares on the London market. During the world-wide depression which ensued, numerous governments defaulted in their interest payments, and railway companies went into the hands of receivers. Confidence in foreign investments was therefore for some years shaken, and investors sought openings for their money at home rather than abroad.

In the early '80's conditions again became favorable for investment. The fields which came perhaps most prominently into favor were Australia, and during the later part of the decade South America. The securities of railways in the United States were also readily absorbed, as they had been during each period of expansion since the beginning of the railway era. In Canada, this was the time of the construction of the Canadian Pacific Railway. In South Africa, the gold and diamond discoveries of 1884–5 resulted in the flotation of hundreds of mining companies. The boom, however, was accompanied by a good deal of injudicious speculation, and culminated during the early '90's in a series of crises in various parts of the world which checked the export of capital for a number of years. A collapse in Argentina in 1890–1 was followed by a slump in South African mining shares and paralysis in Australia. The business position in the United States also became very unsatisfactory, largely as a result of the uncertainties connected with the free silver agitation; and many railways went into the hands of receivers. Consequently, the '90's were a period during which comparatively little British capital flowed abroad. There was, indeed, a not unimportant movement to withdraw capital from America by selling bonds held in England back to New York. This, however, was only temporary; for at a later date the movement of British capital to America was resumed, though the flow in that direction became smaller than before relatively to the flow in other directions.

The export of British capital showed signs of recovery in the late '90's, but the movement was stopped short by the South African War, which absorbed much capital that would otherwise have been available for investment. Two or three years after the close of the war, however, the outflow of capital began rapidly to increase, and the volume of investment soon attained unprecedented proportions.

## Rapid Growth in the Present Century

The vast extent of the export of capital during the opening years of the present century is indicated by the following figures of new capital issues for investment in the colonies and abroad compiled from tables published in the *Economist:*

| | £ | | £ |
|---|---|---|---|
| 1901 | 127,907,000 | 1908 | 142,152,000 |
| 1902 | 57,126,000 | 1909 | 163,675,000 |
| 1903 | 63,591,000 | 1910 | 207,143,000 |
| 1904 | 72,925,000 | 1911 | 165,614,000 |
| 1905 | 120,497,000 | 1912 | 165,514,000 |
| 1906 | 81,906,000 | 1913 | 160,586,000 |
| 1907 | 90,560,000 | | |

These figures cannot be taken as an exact measure of the export of capital, since there is a large amount of private investment abroad, and securities are continually being bought from abroad and sold abroad. Nevertheless, the figures sufficiently indicate the vastness of the outflow of British capital for some years before the present war.

It is of interest to analyze the statistics of capital issues according to countries of destination. This has been done in the *Economist* for a few years back, and the figures are here reproduced.

It will be seen that the new issues for investment in foreign countries have been, on the whole, somewhat larger than the issues for investment in British possessions. The most prominent individual country, however, has almost without exception been Canada. The United States has followed next in order of importance, and behind have come Argentina, Australasia and Brazil. Less capital was raised for India and Ceylon during the second three years than during the first three; but for Russia, on the other hand, more was raised in 1911–3 than in 1908–10.

## The Aggregate Investment and Its Geographical Distribution

The amount and geographical distribution of the aggregate capital publicly invested by British citizens in the colonies and in foreign countries are estimated by Sir George Paish[2] to have been as follows, at the end of December, 1913:

[2] See *The Statist* of February 14, 1914.

Destination of New Capital Publicly Issued

| | Amounts in £1,000's | | | | | |
|---|---|---|---|---|---|---|
| | 1908 | 1909 | 1910 | 1911 | 1912 | 1913 |
| *British Possessions* | | | | | | |
| India and Ceylon | 13,146 | 15,336 | 17,992 | 5,171 | 3,708 | 3,824 |
| South Africa | 6,210 | 11,292 | 3,379 | 4,387 | 3,863 | 6,295 |
| Canada | 27,827 | 26,814 | 36,882 | 41,215 | 46,983 | 44,119 |
| Australasia | 4,028 | 11,380 | 13,385 | 3,333 | 13,462 | 18,629 |
| Other British Possessions | 7,439 | 9,936 | 20,740 | 10,889 | 4,626 | 3,271 |
| Total British Possessions | 58,650 | 74,758 | 92,378 | 64,995 | 72,642 | 76,138 |
| *Foreign Countries* | | | | | | |
| Russia | 3,810 | 9,472 | 3,919 | 5,208 | 10,490 | 8,956 |
| Finland | .. | 2,328 | 143 | 970 | .. | .. |
| Denmark | 2,121 | 488 | 1,089 | .. | 2,425 | .. |
| Sweden | 2,940 | 881 | .. | 200 | .. | 485 |
| Norway | .. | 381 | 50 | 3,009 | 633 | 2,402 |
| United States | 21,472 | 15,905 | 39,590 | 21,314 | 23,635 | 18,746 |
| Brazil | 12,992 | 9,219 | 11,814 | 19,211 | 14,353 | 15,093 |
| Argentina | 15,013 | 21,738 | 22,865 | 16,677 | 20,110 | 11,990 |
| Chile | 1,299 | 4,098 | 4,685 | 8,271 | 2,252 | 2,699 |
| Mexico | 8,113 | 9,110 | 5,087 | 2,650 | 4,086 | 10,642 |
| Central America | 15 | 1,592 | 35 | 291 | 1,017 | 415 |
| Other S. American Republics | 4,226 | 2,616 | 3,141 | 2,414 | 100 | 525 |
| China | 5,031 | 740 | 1,610 | 7,434 | 5,950 | 6,883 |
| Japan | 2,920 | 4,723 | .. | .. | 3,231 | .. |
| Austria Hungary | | | 4,098 | 1,654 | 40 | 108 |
| Bulgaria | | | 3,604 | 216 | .. | .. |
| Greece | | | 1,572 | 687 | 35 | .. |
| France | | | 900 | 245 | 692 | .. |
| Turkey | | | 1,431 | 300 | .. | .. |
| Germany and Possessions | 3,550 | 5,626 | 794 | 223 | 176 | .. |
| Dutch East Indies | | | 4,383 | 568 | 153 | 1,498 |
| Cuba | | | 1,916 | 6,501 | 838 | 891 |
| Philippine Islands | | | 404 | .. | .. | 713 |
| Other Foreign Countries | | | 1,635 | 2,576 | 2,656 | 2,403 |
| Total Foreign Countries | 83,502 | 88,917 | 114,765 | 100,619 | 92,872 | 84,449 |
| Total British Possessions and Foreign Countries | 142,152 | 163,675 | 207,143 | 165,614 | 165,514 | 160,587 |

| India and Colonies | £ |
|---|---|
| Canada and Newfoundland | 514,870,000 |
| Australia | 332,112,000 |
| New Zealand | 84,334,000 |
| South Africa | 370,192,000 |
| West Africa | 37,305,000 |
| India and Ceylon | 378,776,000 |
| Straits Settlements | 27,293,000 |
| Hong Kong | 3,104,000 |
| British North Borneo | 5,820,000 |
| Other Colonies | 26,189,000 |
| Total India and Colonies | 1,779,995,000 |

| Foreign Countries | £ |
|---|---|
| United States | 754,617,000 |
| Cuba | 33,075,000 |
| Philippines | 8,217,000 |
| Argentina | 319,565,000 |
| Brazil | 147,565,000 |
| Mexico | 99,019,000 |
| Chile | 61,143,000 |
| Uruguay | 36,124,000 |
| Peru | 34,173,000 |
| Miscellaneous American | 25,538,000 |
| Russia | 66,627,000 |
| Egypt | 44,912,000 |
| Spain | 19,057,000 |
| Turkey | 18,696,000 |
| Italy | 12,440,000 |
| Portugal | 8,136,000 |
| France | 8,020,000 |
| Germany | 6,364,000 |
| Miscellaneous European | 54,580,000 |
| Japan | 62,816,000 |
| China | 43,883,000 |
| Miscellaneous Foreign | 69,697,000 |
| Total Foreign | 1,934,264,000 |
| Grand Total | 3,714,259,000 |

This total does not include a large amount of capital privately invested abroad, and Sir George Paish estimates that, were this added, the total British investments in the colonies and abroad would amount to £4,000,000,000. While it must be remembered

that capital publicly subscribed in London may, and to a considerable extent does, actually belong to foreigners, and Sir George Paish's estimate to that extent possibly overstated the amount of British investments, at the end of 1913, it is probable that by the end of July, 1914, a further £100,000,000 had been added to the amount of British investments, whatever the figures might have been at the end of 1913. The annual income accruing from these investments at the time of the outbreak of war can hardly therefore have been very far short of £200,000,000 per annum. This income is derived in the main from railway bonds and stocks, and from foreign and colonial government securities. Sir George Paish estimates that of the capital publicly invested in the colonies and abroad no less than £1,521,014,000 was invested in railways and £959,523,000 in government securities. The principal other items are mines £272,789,000; finance, land and investment companies £244,187,000; municipal loans £147,547,000; commercial and industrial securities £145,332,000; tramways £77,790,000; and banks £72,909,000.

### Causes and Effects of This Wide Distribution.

The wide geographical distribution of British investments, as shown in the table above, is worth studying. By far the largest sums have been invested in the United States, Canada, India, South Africa, Australia and Argentina; but more or less important amounts have been invested in practically every other country. On the whole, investments on the continent of Europe are small. Sir George Paish's figures show that for all European countries together the amount is less than £200,000,000, which is only about 5 per cent of the total investments. This has been a very fortunate circumstance for Great Britain in the present war, for it has meant that British investment interests in the principal area of disturbance have been small. The homeward flow of interest on investments in other quarters of the world has continued practically unhindered, while enemy states have not been able to put obstacles in the way of sales of securities to foreigners in payment for munitions and supplies. The cases of France and Germany have been very different. A large part of the foreign investments of both countries are in Europe, and especially in Russia. The suspension of most of the Russian export trade, as a result of the war, made it

difficult to effect payment of interest on capital invested there, and to some extent it has only been possible to obtain interest payments by making further advances. In the case of Germany, the utility of her investments in Russia was, of course, nil, and the same applies to the not inconsiderable investments made by Germans in the British colonies. No interest or dividends are paid to Germans during the war, and transfer to neutrals is stopped.

The causes of the wide distribution of British investments must be sought in the history of British trade relations and British colonial expansion. It was natural that trade should be directed largely to the colonies, which a common language and common institutions tended to draw close to the mother country. Despite political disagreements, identity of race and language has been a potent influence also in encouraging intercourse between Great Britain and the United States. The importance of the British mercantile marine also facilitated trade with other countries in distant parts of the world. Out of trade developed investment, and thus gradually was built up the imposing structure of British overseas investments.

## The Different Nature of French and German Investments

Very different have been the circumstances of French and German investors. The development of France industrially and financially took place at a considerably later date than that of Great Britain, and the sums invested abroad at the outbreak of the present war were correspondingly smaller, amounting perhaps to £1,800,000,000. French overseas trade too has always been much smaller than that of Great Britain, while the course of events in the eighteenth century deprived her of most of her large colonies in Asia and America. The Frenchman, therefore, has exhibited a marked tendency to concentrate his investments in Europe, in Egypt, and in his North African colonies, though French interests in other parts, notably in South America, Mexico and the Transvaal, are considerable, and were, at any rate so far as concerns South America, growing in importance for some years before the war.

German investments abroad also began at a much later date than British investments, and have grown more slowly. At the outbreak of the present war they did not perhaps greatly exceed £1,000,000,000 in amount, and were to some considerable extent offset

by investments in Germany on the part of foreigners. Germany, like France, had until recently no large field for investment in the colonies, and her overseas trade is quite a recent growth. Consequently Germans were inclined to make their investments in neighboring European countries rather than far afield. As in the case of French investments, an important part is represented by holdings of Russian bonds, railway and industrial securities. Germany also has important interests in Austria Hungary, Italy, Roumania and the Balkans. Though German investments are predominantly represented by European securities, German holdings of American railway and other bonds and stocks are (or at any rate were before the war) considerable in amount, as are also her holdings of South American stocks and South African mining securities.

There is another feature of British investments which may also most conveniently be indicated by contrasting it with French and German investments. This distinction depends upon the great differences which exist between countries in regard to the distribution of the ownership of capital among different classes. In Great Britain, the ownership of capital is distributed more unevenly than in either France or Germany. Investors represent a comparatively small section of the community. The control of large amounts of capital is thus vested in comparatively few hands. In Germany, and to an even greater extent in France, the small investor controls a relatively large part of the total capital available for investment. The French peasant is proverbial for his thrift and the number of accounts open at the savings banks and the entries in the Grande Livre of the French national debt alike testify to his financial importance.

It is difficult to form an opinion as to what has been the effect upon investment policy of the uneven distribution of the ownership of capital in Great Britain. No doubt concentration of capital in a few hands facilitates the promotion of large schemes of investment in distant parts of the world. The wealthy investor is, on the whole, better educated in financial affairs than the small investor, and it is probable that he is able to select his investments in distant fields with more discretion than the small investor, and to obtain a higher return on his capital without running undue risks. The characteristic of the small French investor is his caution; he prefers government securities or debentures yielding a low fixed

interest. On the other hand, the small British investor, whose psychology is different, is somewhat apt to allow himself to be carried away by golden promises and to lose his capital in speculative ventures. It must, of course, also be borne in mind that very large holdings of foreign securities are in the hands of banks, insurance, finance and trust companies, etc., which accumulate and control the capital of individuals, many of whom may be comparatively poor. Many millions of the American securities which have been sold in New York or deposited as collateral for loans with American bankers during the present war belonged to institutions of this kind.

## THE EFFECTS OF THE WAR

In concluding this survey of British foreign investments a few words may perhaps be said about the future. The European war has wrought great changes in the sphere of investments, as in other spheres. From the point of view of Great Britain, the main factors have undoubtedly been the extensive realizations of the more liquid and saleable assets in various parts of the world and the vast loans which have been granted to the Allied governments. The principal result of the former movement has been a vast pouring back into the United States of American securities slowly accumulated during the past century. Of the latter movement, the details are less fully known, but it may safely be asserted that some hundreds of millions sterling withdrawn from the United States have been lent to Russia. No doubt the sums lent to the other Allied governments are considerably smaller.

It may be presumed that the amounts lent to the Allied governments will remain after the war as a debt due. It appears not unlikely, however, that the ownership of the debts due from the Allies will be transferred from the British government to individual investors by the issue of loans on the London capital market, the proceeds of which will be handed over to the British government. This, however, would be largely in the nature of a bookkeeping transaction from the national point of view. The opinion may further be hazarded that the war will have to a considerable extent a permanent influence upon the distribution of British investments. It appears certain that the financial position of America will be much strengthened both absolutely and relatively to other countries. Even before the war the United States was becoming less dependent

upon Europe for its supplies of capital, and was even investing abroad in Canada and in South America. The inference appears to be warranted that the British investor will not fully regain the position which he held in the United States before the war. Doubtless there will be a partial recovery both by the repurchase of American securities, and especially by the repayment of money borrowed upon collateral securities deposited in America, but it will probably not be complete. The future of the British investor in Canada and in South America appears to be better assured, although even in those fields there may be more competition from the United States than before the war.

Another effect which the war appears likely to exercise upon the distribution of British capital is to encourage investment in Russia. Doubtless Russia will for many years have to borrow in order to pay the interest on the huge debt which she will owe. It appears probable that British interest in Russia, increased by the war, will be widened to embrace a keen desire for the development of the country, resulting in extensive investments of British capital in Russian railways, municipal loans, mines, manufacturing industries, etc. The likelihood of such a movement appears to be enhanced by the fact that for some years before the present war the flow of British capital to Russia had been increasing.

With regard to the general question of the amount of British capital exported after the war, it does not seem likely that this will be permanently affected. The general conditions which have made Great Britain a creditor country will remain substantially unaltered. It is possible that the amount of capital exported may for a time be small as compared with what it was before the war, but there is no reason to doubt that the flow will sooner or later recommence in large volume. If, as there is cause to expect, new habits of economy and thrift have been acquired during the war by various sections of the population, it may well be that the accumulation of capital in Great Britain and the outflow for investment overseas will speedily attain new records.

# THE AMOUNT, DIRECTION AND NATURE OF FRENCH INVESTMENTS[1]

By Yves Guyot,
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It has been the fashion, in official speeches, in parliamentary reports and debates, to state that "France is the great banker of the world, that she is creditor everywhere and nowhere debtor"; and at the same time to say: "There is no capital left in France for French undertakings." M. Briand, President of the Council (Prime Minister), speaking in 1909, stated: "French gold streams over the entire world. If we may be allowed to express anxiety or regret, it is because none remains in the country itself." M. Raymond Poincaré, then Minister of Finance, now President of the Republic, said: "France is an indefatigable creator of wealth. She works, she produces, she economizes, and that is why her market is always the biggest reservoir of capital in the world." And he added: "Perhaps it might be better that the largest portion of this wealth be employed in commercial and industrial undertakings."

For the authority of these important personages I regret to state that before uttering such words they should have studied the facts. It is not exact that France is "the greatest reservoir of capital," or "the greatest banker of the world." A glance at the London market suffices to set aside such an assertion. The flotations of securities on the London market are far more important than those of the Paris market. British investments in the colonies and abroad are, according to Sir George Paish, estimated at 100 billion francs; those of France at 40 billions. The London Bank deposits were three or four times as great as those of Paris. Finally we have, as international currency, the *draft on London* whose prestige is due

[1] Principal references. *Annuaire des valeurs cotés à la Bourse de Paris*, publié par la Chambre Syndicale des agents de change. (N'a pas paru depuis la guerre.) *La Statistique internationale des valeurs mobilières. X^e rapport présenté au nom du comité des finances de l'Institut international de statistique*, par Alfred Neymarck, à la session de Vienne, 1913. (Publié en 1916).—*Le Marché Financier* par Arthur Raffalovich, 23d année 1913–1914 (publié en 1915) et années précédentes.

to free trade, to the liberty of the London market and to the gold standard which has been established there since 1816.

According to the *Census of Production of 1907*, drafted for the United Kingdom by Mr. W. Flux, and published in 1911, the available capital at the close of the year amounted that year to 340 to 400 millions of pounds, or about 8 and a half billions of francs. In France, the yearly scope of savings was estimated at about 3 billion francs.

How were these available funds distributed? MM. Briand and Poincaré were acting as the spokesmen of the financial protectionists when they denounced the investment of capital out of France. A publicist named M. Letailleur, writing under the name "Lysis," directed a violent campaign against the large discounting houses which he denounced for "draining French capital away to foreign countries, and depriving trade and industry at home thereof." A professor of political economy at the University of Nancy, Mr. Brocard, repeated: "By acting in this manner, we behave like a manufacturer who, having available capital, allows his competitors to make use of it, and lets his own business run to seed, for lack of funds."[2]

In such words as we have quoted above, we notice two mistakes. The first is brought about by a fault, too common among Frenchmen, and which foreigners are well acquainted with: French vanity. "The foremost banker of the world," "the great reservoir of capital!" The phrase was flattering to the audience. Political speakers repeated it, therefore, without troubling to first ascertain its degree of veracity. And among the audience, many who had never seen millions except in the columns of newspapers, proudly reflected:

> Ah! yes, we are the richest nation of the earth; and if I, personally, am not rich, it is because there are persons who turn these riches off towards foreign countries, whereas a part of them should belong to me. The big financiers grow wealthy at my expense! Proper laws must be made to prevent such a state of things, and to give me back my share of those millions!

Ministers and deputies promised to see to it; and in truth, they have adopted some measures of the kind, which I will mention later on.

[2] Conference at the Écoles des Sciences Politiques, 1912.

Then the assertion that French savings were all turned off towards foreign countries was not exact. It will be seen further on that 63 per cent of the negotiable securities on the French market and the property of Frenchmen are French securities; and to these must be added capital which does not figure on the markets, and which play a considerable part in the economic activities of France.

## MONEY MARKETS IN FRANCE AND NEGOTIABLE SECURITIES

1. *The Official Market of the Paris Bourse.*—The official market is the Paris Bourse. The 70 stockbrokers, appointed by decree, are alone entitled, by virtue of article 76 of the Commercial Code, to negotiate public and other securities which they have inscribed on their stock-list, and they alone are qualified to establish the prices. The government since 1880 and especially during the last years intervenes to admit such and such a security on the official quotation list, or to reject it. In this manner the government sets itself up as master of the market. Under the influence of the French metallurgists, it thus caused, in 1909, the ordinary shares of the United States Steel Corporation to be refused admission to the French market, and it compelled admission of a Turkish loan in 1914.

The following list gives the number of securities and certificates negotiable on the official market of the Paris Bourse, at ten years' interval:

| On Dec. 31 | Number of securities | Number of certificates millions |
|---|---|---|
| 1902 | 1,078 | 148.6 |
| 1912 | 1,456 | 135.2 |

| | Million francs | |
|---|---|---|
| | Nominal capital | Market value according to quotation of Dec. 31 |
| 1902 | 130,303 | 130,119 |
| 1912 | 145,332 | 142,198 |

The increase from 1902 to 1912 was in nominal capital 15 billions, or 1,500 millions per annum; the increase in market value was 12 billions, making a loss of 3 billions.

Of these 142 billions of securities, 100 billions in round figures, or more than 71 per cent, are composed of government stock and fixed interest securities.

SECURITIES NEGOTIABLE ON THE OFFICIAL MARKET OF THE PARIS BOURSE IN DECEMBER 1902 AND 1912

| | In millions of francs | | | | Proportion of each group in 1912, per cent |
|---|---|---|---|---|---|
| | Nominal capital | | Capital at prices of Dec. 31 | | |
| | 1902 | 1912 | 1902 | 1912 | |
| *French securities* | | | | | |
| French state stock | 25,929 | 25,310 | 25,850 | 22,749 | 32.45 |
| State railway bonds | ..... | 298 | ... | 303 | 0.43 |
| Treasury bonds | 100 | 214 | 100 | 214 | 0.31 |
| Colonies and protectorates | 467 | 1,030 | 438 | 870 | 1.24 |
| City of Paris | 2,002 | 2,275 | 1,984 | 1,977 | 2.82 |
| Departments and towns | 208 | 126 | 210 | 115 | 0.17 |
| Insurance companies | 108 | 118 | 729 | 943 | 1.34 |
| Crédit Foncier | 4,312 | 5,033 | 4,231 | 4,612 | 6.58 |
| Banks, credit establishments | 1,370 | 2,707 | 2,268 | 5,258 | 7.50 |
| Canals | 144 | 499 | 1,611 | 2,439 | 3.48 |
| Railroads: East, Lyons, Midi, Orleans, West | 17,962 | 18,605 | 19,612 | 18,175 | 24.93 |
| Railroads and tram-lines | 1,970 | 3,089 | 1,787 | 2,842 | 4.06 |
| Docks | 138 | 133 | 133 | 129 | 0.18 |
| Water | 254 | 252 | 413 | 435 | 0.62 |
| Electricity | 394 | 970 | 363 | 1,272 | 1.81 |
| Spinning-mills | 19 | 52 | 22 | 71 | 0.10 |
| Gas | 364 | 505 | 639 | 581 | 0.83 |
| Forges, foundries | 518 | 783 | 677 | 1,692 | 2.41 |
| Coal mines | ..... | 147 | 1,136 | 1,713 | 2.44 |
| Metallurgical mines | 320 | 205 | ..... | 732 | 1.04 |
| Phosphates, manure, chemical products | 107 | 251 | 270 | 682 | 0.98 |
| Ports | 23 | 231 | 24 | 256 | 0.37 |
| Transports | 552 | 641 | 392 | 584 | 0.83 |
| Various securities | 2,569 | 798 | 1,139 | 1,454 | 2.08 |
| | 60,132 | 64,597 | 64,027 | 70,105 | 100.00 |
| *Foreign securities* | | | | | |
| Russian state stock | 11,323 | 13,607 | 11,305 | 12,569 | 17.43 |
| Various state stock | 50,080 | 51,779 | 47,487 | 44,237 | 61.36 |
| Banks, insurances | 819 | 3,685 | 1,105 | 5,065 | 7.03 |
| Railways | 7,113 | 9,765 | 4,927 | 7,102 | 9.85 |
| Miscellaneous securities | 836 | 1,898 | 1,269 | 3,120 | 4.33 |
| Total | 70,172 | 80,735 | 66,093 | 72,094 | 100.00 |
| Grand Total | 130,304 | 145,332 | 130,120 | 142,199 | 100.00 |

In 1912, the proportion of French negotiable securities was 42.27 per cent, while that of foreign securities was 57.73.

2. *Departmental Bourses.*—These 142 billions do not represent the total amount of negotiable securities in France; to them must be added the total of the negotiable securities in the departmental bourses of Lille, Lyons, Marseilles, Bordeaux, Toulouse, Nantes; but care must be taken not to duplicate: the securities proper to the departmental markets may be estimated at 5 billions.

3. *Bank Market.*—But, in addition to the securities listed on the official bourses, there are securities negotiable at the bank. On December 31, 1902, the securities negotiable for the account and in full, represented 7,092 million francs, securities negotiated in full represented 8,056 million francs, a total of 15,148 million francs. From 1903 to 1912 securities were introduced on the market, amounting to 19,654 million francs: this gives us therefore a total amount of about 35 billions.

But Mr. A. Neymarck considers that numerous variations of prices may have altered the estimated value of securities as of 1902 and the value of the securities since introduced; that these securities may in some cases have disappeared, while others have been admitted to the official stock-list, and hence, Mr. A. Neymarck writes down as 20 or 25 billion francs, the amount of securities negotiable at the bank.

*Total of the Three Markets.*—The figure of securities negotiable in France at the close of 1912 can be estimated in the following manner:

| | Billions of francs |
|---|---|
| Paris Bourse, official market | 142 |
| Bank market | 23 |
| Departmental market | 5 |
| | 170 |

Which amounts to this: that 170 billions of securities are negotiable in France; many of these, like the British Consolidated and the state funds of the various countries are negotiable on several markets. These 170 billions are therefore not the exclusive property of the French market and still less of Frenchmen.

## THE FRENCH PART

What share in these 170 billions does the property of Frenchmen represent? According to official statistics of the Registration,

Estates and Stamp Office, the duties and products secured during the year 1911 on the revenue of personal securities was 109,695,000 francs. This amount of duty on personal securities applies to French securities, except the French government stock and foreign government stock which are not subject to the tax. The following is the statement:

| | Francs |
|---|---|
| *French securities:* | |
| Companies' shares | 48,098,000 |
| Interest shares | 826,000 |
| Limited liabilities | 1,865,000 |
| *Bonds and Loans* | |
| Communes (rural districts) | 2,850,000 |
| Departments | 115,000 |
| Public establishments | 1,832,000 |
| Companies | 35,460,000 |
| Total for French securities | 91,046,000 |
| *Foreign securities:* | |
| Companies' shares | 9,352 |
| Bonds | 8,221 |
| Companies owning property in France | 1,130 |
| Total for foreign securities | 18,703 |

These 110 millions correspond to a total figure of 2,844 millions of francs of taxed revenue, which may be divided up in the following manner:

| | Million francs |
|---|---|
| For the French securities | 2,371 |
| For the foreign securities | 473 |
| | 2,844 |

After certain deductions, amounting to 102 millions are made, the remaining securities from which this revenue is derived is 2,742 millions which, taxed at the rate of 4 per cent, represent the 110 millions of duties noted above.

It will be seen that the French securities of varying income, shares, etc., furnish more than 50 millions of the revenue, a figure exceeding that from the fixed revenue securities; the same applies to the foreign companies.

The income received by the owners of these French securities, of varying return, according to the 4 per cent tax is 1,250 millions;

that received from the foreign companies' shares is 225 millions; we have, therefore, a revenue of 1,475 millions out of a total taxed revenue of 2,844 millions, or more than half. It is not exact, therefore, to say that the French invest their capital only in fixed revenue securities.

But the government stock, both French and foreign, then free from the 4 per cent tax, is not included in this estimate; they would, however, give a majority to the fixed revenue securities. M. Neymarck estimates French investments in foreign government stock at 25 to 30 billions.

The income received from French and foreign securities owned by Frenchmen is estimated at the close of 1912 to be:

| | Francs |
|---|---|
| 1. Total amount of taxed income from French securities, deduction being made of prizes and repayment premiums....... | 2,275,000,000 |
| 2. Income from French 3% and 3% redeemable funds......... | 760,000,000 |
| 3. Income from 30 to 32 billions foreign government stock, not subject to income tax of 4%.......................... | 1,600,000,000 |
| 4. Income from foreign securities, deduction being made of premiums and prizes for reimbursement................... | 346,000,000 |
| 5. Premiums and prizes on French and foreign securities....... | 102,000,000 |
| | 5,083,000,000 |

In round figures the income received from government stock and French securities amounts to 3,100 millions; the foreign state funds and securities to 2 billions. To these figures should be added the income from the foreign government stock and securities purchased abroad and remaining deposited abroad until the day when, as a consequence of some public action, or by reason of a legacy or a division of property, they make their appearance, but it is not possible to give any reliable estimate of this item.

Mr. A. Neymarck estimates the capital which may be represented by these yearly incomes at 115 billions; but he does not indicate the elements used for such an estimate.

If we take the rate of 4 per cent for the shares, we reach a figure of 31,250 millions which must be included in the first item of the following table:

| | Billions |
|---|---|
| Treasury notes and bonds, state railroad bonds, colonial funds.......... | 50 |
| French state 3% and 3% redeemable funds.......................... | 23 |
| Foreign government funds.......................................... | 7 |
| French and foreign "lottery" securities............................ | 5 |
| Total.................................................... | 85 |

We may deduct 10 per cent for the French state funds, and securities which may be owned by foreigners, or about 7 billions. There then remains 108 billions forming the capital in personal securities of French capitalists, which would yield a revenue of 5 billions of francs.

In the next table is given the progression followed by the said capital in personal securities:

| | Amount of capital in French portfolio | Billions of francs Of which the foreign securities (state funds included) represent |
|---|---|---|
| Close of 1850 | 9 | .. |
| 1860 | 31 | .. |
| 1869 | 33 | 10 |
| 1880 | 56 | 15 |
| 1890 | 74 | 20 |
| 1902 | from 87 to 90 | from 25 to 27 |
| 1904 | 90 to 93 | 27 to 30 |
| 1906 | 97 to 100 | 30 to 32 |
| 1908 | 103 to 105 | 32 to 35 |
| 1910 | 106 to 110 | 38 to 40 |
| 1912 | 108 to 115 | 40 to 42 |

Out of the 40 to 42 billions of foreign securities, we may estimate that there are 30 to 33 billions in foreign funds, 10 to 12 in shares and bonds. The foreign securities would thus represent 37 per cent of the French capitalist's portfolio. It is, therefore, not correct to state that all French savings are drained outside the country. The proportion of investments abroad in 1890 was 27 per cent. It would thus have increased by 10 per cent since that date.

The causes of the increase may be summed up as follows:

1. The conversion of the 3 per cent French stock diminished their yield and Frenchmen, anxious to have an income sufficient to ensure the style of life they choose to live, looked abroad for higher returns. Hence, the fall of state stock, and of the "gilt-edged" securities. This phenomenon is not confined to France.

2. The fiscal threats of the income tax led to the exportation of a certain amount of capital and its investment in foreign securities.

3. While, in Parliament, the statesmen groaned over the exportation of capitals to foreign lands, for political reasons they encouraged investments of capital in Russia and in other

countries; in 1914 Mr. Caillaux made use of all the influence which can be exercised in France by a Minister of Finances, on the official market, and with the discounting houses, to bring about the flotation of a first block of 500 millions of Turkish loan.

## THE FRENCH MARKET IN 1912 AND 1913 AND THE MINISTERS OF FINANCE

The following are the admissions and introductions of securities in 1912:

French Securities

| | Number of certificates | Millions of francs: Nominal value | Value at first quotation | Value at price quoted in December |
|---|---|---|---|---|
| State and town funds | 1,326,001 | 519.1 | 512.9 | 505.8 |
| Shares | 2,011,810 | 458.6 | 917.6 | 895.8 |
| Bonds | 3,293,772 | 1,746.5 | 1,121.7 | 1,087.1 |
| Parts | 23,000 | ...... | 8.5 | 7.4 |
| Totals | 6,654,583 | 2,724.2 | 2,560.7 | 2,496.1 |

Foreign Securities

| | Number of certificates | Nominal value | Value at first quotation | Value at price quoted in December |
|---|---|---|---|---|
| Funds—provinces and towns | 1,212,080 | 539.5 | 519.0 | 502.1 |
| Shares and bonds | 1,448,268 | 638.0 | 902.9 | 909.3 |
| Parts | 1,145,440 | 533.3 | 505.0 | 490.1 |
| Totals | 3,805,788 | 1,710.9 | 1,927.0 | 1,901.5 |

In 1913, the admissions and introductions were less important:

French Securities

| | Number of certificates | Millions of francs: Nominal value | Value at first quotation | Value at December quotation |
|---|---|---|---|---|
| State funds, departments and towns | 310,987 | 155.5 | 151.6 | 151.8 |
| Shares | 1,904,320 | 479.2 | 894.9 | 854.3 |
| Bonds | 2,168,871 | 1,066.4 | 1,023.4 | 1,015.2 |
| Parts | 18,000 | ...... | 22.8 | 22.4 |
| Total | 4,402,178 | 1,701.1 | 2,092.7 | 2,043.9 |

Foreign Securities

| | Number of certificates | Nominal value | Value at first quotation | Value at December quotation |
|---|---|---|---|---|
| State funds, departments and towns | 1,291,833 | 649.3 | 624.5 | 647.8 |
| Shares | 880,137 | 323.9 | 474.6 | 461.7 |
| Bonds | 1,263,246 | 631.6 | 598.6 | 598.1 |
| Totals | 3,435,216 | 1,604.9 | 1,697.7 | 1,707.6 |

The following is a comparison between those two years and the three preceding ones:

| | Number of certificates (French and foreign) | Nominal value | Millions of francs Value at first quotation | Value at end of December |
|---|---|---|---|---|
| 1909 | 9,369,731 | 3,397 | 3,473 | 3,712 |
| 1910 | 12,110,949 | 5,068 | 4,740 | 4,754 |
| 1911 | 9,255,393 | 3,739 | 4,088 | 4,068 |
| 1912 | 10,460,371 | 3,835 | 4,487 | 4,398 |
| 1913 | 7,837,394 | 3,306 | 3,790 | 3,751 |

The value at the close of December is lower during the past three years. The figure of admissions and introductions in 1913 was inferior to that of any of the preceding years.

The case was the same on the Bank market.

| | Number of certificates | Nominal value | Million francs Value at first quotation | Value at end of December |
|---|---|---|---|---|
| 1909 | 11,487,680 | 791 | 1,642 | 1,536 |
| 1910 | 9,444,124 | 973 | 1,385 | 1,310 |
| 1911 | 7,540,271 | 736 | 888 | 837 |
| 1912 | 12,766,380 | 869 | 1,202 | 1,203 |
| 1913 | 5,351,460 | 609 | 1,041 | 930 |

The intervention of the government is not without responsibility in this connection. On December 21, 1912, M. Klotz, Minister of Finance, speaking at the Chamber of Deputies stated:

> In 1910 the admission to the quotation-list of foreign securities amounted to 3,829 millions and the admissions to the quotation-list of French securities were 731 millions. In 1911 there were only 2,784 millions of foreign and 620 millions of French securities admitted. In 1912, only 1,655 millions of foreign securities against 1,782 millions of French securities were admitted to the quotation list, French undertakings.

The Minister of Finance exulted at the decrease of the market, while quoting figures which do not agree with the official figures which we have just given. And that same minister had not failed to say also: "France is creditor everywhere and debtor nowhere."

The arbitrary intervention which the Minister of Finance boasted that he had introduced on the market, could only have one result: the decrease of French credits abroad. The Ministers of Finance have resolutely striven, since 1897, to decrease the importance of the French market. In 1897 they reinforced the monopoly

of the 70 stockbrokers. Since then, in 1907 by threats relating to the tax on state fund, they have shaken French credit and have contributed to lower the "rente."

The repercussion of the Balkan war caused a fall at the Paris Bourse which, for the 162 principal securities, may be figured out as follows: their normal value was 57,534 million francs; on December 31, 1912, 56,260 millions; on June 30, 1913, 53,843, or a fall of 2,417 millions. This fall amounted in the case of the French state funds to 1,346 millions; for French railroad bonds to 554 millions; for industrial companies' shares to 287 millions; and 228 millions for the bonds of the City of Paris and the Crédit Foncier.

The reduction of the working hours in the railroad companies led to new expenses for extra staff, the law of July 21, 1909, concerning pensions for workmen and employes of the railroads caused a fall not only of the shares, but of the bonds which, after the French state funds, composed the majority of the stock of French investment; the Northern Railway 3 per cent bond which was worth 453.50 in 1908 had fallen to 420 francs in 1913 and at some time during that year it even got down to 402 francs.

The law of March 29, 1914, aggravated, from July 1, 1914, the régime of foreign state funds. They were to pay, at the time of their flotation, a stamp duty fixed at 2 per cent of the capital. Their coupons, until July 1, 1914, were exempt from the income tax. From July 1, 1914, they were subjected to a 5 per cent tax. The Treasury first desired to establish it on the nominal gross revenue, without taking into account the taxes which they could be subjected to in their own country. Finally the treasury consented to collect the tax only on the net coupons.[3]

Colonial funds, free from taxes, are subjected to the income tax. The colonies will have to pay, for they have undertaken to bear the taxes imposed by the metropolis.

The law of March 29, 1914, aggravated the charges which burdened the market of Paris, and yet, Mr. Jacques Gunzberg had no difficulty in showing that they were heavier in Paris than in London. The cost of a flotation varied between 4 and 4½ per cent to be thus distributed: expenses of the guarantee syndicate from 1¾ to 2 per cent; cost of "guichet" 1½ per cent; advertising costs ½ per cent; these were about the same conditions as for the London market.

[3]*See* A. Raffalovich, *Le Marché Financier*, 1913–14, T. 23, p. 387.

But the Treasury altered this similarity of conditions. Whereas in England, on the funds certificates and public securities, the Treasury collected only a stamp-duty cash, of 1 per cent, in France the Treasury collected a duty of 3 per cent after 1913.

The same goods therefore cost 5½ per cent in London and 7½ per cent in Paris. Hence, the issue of a Belgian loan in London and not in Paris. Why should Belgium have given preference to the London market? The English banks took a margin of 3 per cent between the guaranteed price and the issue price, underwriting at 74 that which they sold at 77. The Belgian state paid besides the 1 per cent of the English tax. It therefore received 73 net. All included, its expenses amounted to 4 per cent. In France, paying 3 per cent to the Treasury, the Belgian state would only have collected 71 francs, the expenses being 6 per cent in Paris instead of 4 per cent in London. An Argentine loan, which had been negotiated by a French syndicate, was also floated in London.

Much trouble was taken to "nationalize" certain American securities, as though the very advantage of these international securities were not to retain that nature,—confining their market, one could not increase their price. When the war came, we realized the mistake which had been made. The present Minister of Finance is too glad to obtain the loan of securities of neutral powers to seek to improve French exchange in the United States. Were it not for the measures taken on the Paris market against foreign securities, he would have at his disposal a greater quantity than he has been able to procure. We do not know the exact figure, but at the close of July, mention was made of one billion francs.

Under these conditions France could not be "the foremost banker of the world" and those who gave her that title were doing all in their power to restrict her market. Commercial protectionism has for its object to prevent the entry of goods: financial protectionism aims to prevent the exit of capital.

A decree of August 10, 1916, has just raised the commissions of stockbrokers. The report which precedes this decree, signed by the Minister of Finances, states that "the net product, deduction being made of expenses, far from increasing with the development of personal fortune, has decreased by more than 20 per cent in ten years." In 1914, on the eve of the mobilization, the stockbrokers suspended payment of recharges, which entailed the moratorium

suspending reimbursement of the bank deposits. We had to wait till September 30, 1915, for the Syndical Chamber to agree, for the purpose of settling all differences, to a loan, in 6 per cent notes, of 75 millions, "an appreciable fraction of which, says the report, will no doubt remain on its hands."

The decree raising the tariff gives the Minister of Finance the right to modify it "without it being necessary to subject such initiative to a previous proposition of the Syndical Chamber." It is probable that, in a few years from now, it will be necessary to reorganize the Paris bourse. Before the war, the average daily transactions for cash, were about 23 millions; at present they amount to 14 millions, 6 millions of which are for the 5 per cent rente.

### Capital Unrepresented by Securities

The negotiable securities handled on the markets are far from representing the capital of France and especially that part of the capital engaged in industrial and commercial undertakings. The ministers whose words I have quoted do not seem to realize the importance of cryptogamous finance. Thus on twenty coal mines, which in 1908 produced 29 millions of tons of coal, there are eight: Aniche, Auzin, Dourges, Lens, Noeux, Montrambert, Grand' Combe, Carmaux, whose capital has no nominal value.

The capital of Bruay is 3 millions, on which, in 1852, 1,040,000 francs were paid. Its shareholders built up the capital with their profits instead of dividing them as they arose. In proportion to the tonnage produced, Bruay must represent a capital of 120 millions of francs, its dividend being 13 millions. It works out at something over 11 per cent and is the highest rate for French coal-works.

The Company of Lens was founded the same year with a capital of which 900,000 francs were paid. According to the 1910 report, the total figure of the accumulated but undistributed funds of the company, thanks to the funds built up year by year on the profits, has risen to more than 123 millions of francs. The report of 1911 estimated the capital at 141 millions to which should be added 17 millions of supplies of all kinds, giving 158 million francs. The dividend of 12,600,000 francs is 8 per cent of this.

The financial markets have never registered these phases of the mines capital. It is only during the last twenty years that they

issue bonds, and they only issue them for the necessary balancing of their accounts with the Public Works Office.

The 1912 balance sheets of the great metallurgical establishments indicate the presence of reserve funds and provisions of considerable importance, but which are far from showing up all the amortizations and reserves which have been effected previously with the purpose of suppressing accounts. These companies do not need financial assistance, they do not issue securities on the market; when they require capital, they ask it from their shareholders who subscribe it and keep it. None of these establishments complain that "Capital is lacking for French undertakings."

As regards the textile industry, the case is the same, if we believe the investigations made by the Chamber of Deputies between 1902–1906, and by the paper *Finance-Univers* in 1913, to which 2,500 heads of establishments responded. In the North, direct management by private individuals, the owners of factories, is the most usual form adopted. When limited companies are formed, it is, as a rule, to facilitate family divisions of property; but the shares remain in the hands of their members. For cottons and for silks everywhere the same replies are given: "Capital is so far from being scarce that certain firms have too much interest to pay because they have capital belonging to relations and friends on deposit."

"As regards the silk trade," says Mr. Isaac, president (honorary) of the Chamber of Commerce of Lyons, "Lyons is, with Milan, the largest silk market. Lyons finances Milan in many instances."

And we find the same replies for the wool trade; the syndicate of mill-owners of Tourcoing says: "The increase which has occurred in the wool trade results from the importance of the owners' families; they must find work for all their children." All the wool centers have made similar assertions.

Mr. Seydoux, the great wool manufacturer, states:

> Wool and silk are costly raw materials; consequently the trades employ a great deal of capital and proportionately distribute few salaries. If, therefore, the wool and silk trades can export, it is because they have at their disposal cheaper capital than abroad. "And that which tends to confirm this view," added he, "is that much capital goes abroad and helps to found establishments where silk and wool are dealt with—therefore the remuneration of capital is smaller in France than abroad." And he showed that, in the wool trade, "it was the articles which need less work and most capital which are best adapted for exportation."

M. Louis Guérin, president of the flax and hemp mills syndicate, states: "Capital is abundant in the North. It has been built up by accumulation of successive profits." As for tulles and laces, M. Henon, president of the Chamber of Commerce at Calais, said: "Capital is not lacking on our market for men of experience and energy."

In 1910 I examined a statistical work including 98 textile companies of France. Each of these owned capital exceeding 500,000 francs. Together their capital represented 247,954,000 francs. The capital of the companies which publish no balance sheet was 147,462,000 francs. They had not issued any bonds, but they received loans which increased their capital in lesser or greater proportion. A part of the profits which was used to repay these loans was thus dissimulated by book entries. This is a legitimate bookkeeping artifice, no one being forced to increase tax receipts to his own detriment.

As regards the electrical industries, MM. Eschewege and Legouet estimated their capital in 1912 at 1,600 millions of francs.

MM. Poincaré and Briand were therefore wrong to speak of a lack of capital for trade in France. And Mr. E. Lemberger, director of the "Wiener Lombard et Escompte Bank," showed his ignorance of the condition of France when he said, in the *Neue Freie Presse*, on April 22, 1916: "Credit for national trade is a quite unknown thing in France for more than thirty years past." But an Austrian may be excused for ignoring that which French ministers ignore; and these latter may even be excused; for the fecundity of trade capital is not manifest. It is cryptogamous capital.

### Geographical Distribution of French Capital

The distribution of French investments in foreign countries could only be approximately established by the Registration Office. That office does not publish its information. In 1902, the Minister of Foreign Affairs published an "evaluation abroad of the French investments in all forms, including loans, companies securities, industrial and commercial transactions." The total figure was 30 billions: but that table has never been regarded as an authority.

Among the quoted securities, the various state funds were estimated on December 31, 1912, at 44,237 million francs and those of the Russian state at 12,569 millions, or a total of 57 billions. We

have seen that the amount owned by French people was estimated at 30 billions. Russian funds fill their portfolios for a figure of several billions, but not for the total amount written on the quotation list. Considerable quantities of Russian securities were absorbed by the Russians, following good crops which had led to important exportations of wheat. It is true that this figure did not include the whole Russian debt, which at that time amounted to 8,841 million roubles, but Mr. A. Raffalovich, agent for the Ministry of Finance of Rusisa, in Paris, was able to declare: "The share of Russian capitalists in the ownership of securities of the national debt is very important and must come near to half the entire amount."

The Italian State fund whose biggest stock was in France has been transferred to its own land. A portion of the Spanish debt has also gone back to Spain.

At the time of the Balkan war (Oct. 1912) it was calculated that the share of France in the capital placed in Turkey was 2,500 millions of francs, that of Germany 900 millions and that of Great Britain 750 millions. More than 55 per cent of the Ottoman debt belonged to Frenchmen, 30 per cent to Germans and 5 per cent to Englishmen. The distribution of French money invested in Turkey was as follows: State funds, 1,500 million francs; railroads, 375 millions; banks and credit establishments, 87 millions; land property, 100 millions; mining and industrial enterprises, 62,500,000; commercial establishments, 56,250,000 francs; shipping, 50,000,000 francs. France owned four-fifths of the foreign capital employed in credit enterprises in Turkey.

On April 9, 1914, Franco-Turkish agreements were signed with a view to the issue of an 800 million franc Turkish loan in exchange for railroad and port concessions. A first block of 500 million francs was issued at 93.25. It was a 5.36 per cent investment, without counting the reimbursement premium. The public took up 350 millions of francs and 100 millions remained to the account of the syndicate which made an advance of 80 per cent; 50 millions had been taken up by a financial group. This loan, imposed by the French government on the Paris market, burdened it at the time of the war.

The second Balkan war had an effect which proved disastrous for the funds of the Balkan nations and a strain on nearly all of the

great European banks because they were burdened with Treasury notes or short-time securities subscribed by the belligerents and not paid for at date; but it was not only the French banks which were hit.

On February 2, 1914 a convention was signed between the Greek and the French governments relating to a loan of 500 million drachmas (francs). On a first block of 250 millions, 175 were reserved for the French market.

In 1914 Servia issued a 250 million franc loan in Paris, 75 millions of which were taken up by a group of bankers in repayment of advances recently granted and 175 millions were offered to the public. It was guaranteed by the receipts of the Monopolies administration, whose net receipts of 43,907,000 francs showed an excess of 11,513,000 francs.

The French have invested several billions in the Argentine Republic and in Brazil, but we have no documents allowing us to state a figure. It has been said that the French investments in the United States amounted to 5 billions. The transactions to which the rate of exchange has given rise, prove that the figure is exaggerated.

I might have covered the paucity of this information regarding the geographical distribution of French capital by copying out some items from the Bourse quotation list; but they cannot give any precise indications as to the distribution of French investments abroad.

### The Distribution of Capital in France and Financial Optimism

There are somewhat over 8 million owners of lands and houses in France. If we multiply the number of members of the family by 4, a very moderate estimate, we find that more than 32,000,000 persons are interested in the ownership of a house or some ground, generally both.

Personal estate is no less divided. The capital of the Bank of France is very much broken up itself; its 182,000 shares belong to 32,700 shareholders; the 450,000 shares of the Crédit Foncier belong to 43,850 shareholders. The Société Générale has more than 100,000 shareholders; those of the Crédit Lyonnais, of the Comptoir d'Escompte, can be counted by tens of thousands.

On January 3, 1913, the 657 millions of 3 per cent state funds were thus divided between 4,443,000 inscriptions:

| | Number | Amount of rents |
|---|---|---|
| Nominative inscriptions | 1,345,576 | 461,913,675 |
| Mixed inscriptions | 92,181 | 7,446,329 |
| Bearer inscriptions | 3,006,347 | 188,306,519 |

The most numerous among the bearer inscriptions are those of 30 francs, numbering 663,747; then the 20 francs, numbering 395,-613; then 50 francs, numbering 278,109. The 300 francs number only 79,932; the 1,000 francs 19,457, and the 3,000 francs 7,924. The railroad companies' bonds also belong to a great number of small bearers.

Once the French small capitalist has got the income he has decided upon for his needs, he feels great delight in reinvesting the surplus. If he receives payment of a bond, he hastens to use the sum for a new investment. Out of the 3 or 4 billions available at the close of each year, several hundred millions are used for repairs, construçtions, rural, urban or industrial improvements. Some hundreds of millions may be invested in mortgage loans and in insurance premiums; we may consider that 1,500 millions to 2 billions remain available for security purchases.

At the end of two years of war, financial optimism in France is equal to the political and military optimism. If anyone had predicted at the beginning of the war that at the end of September, 1915, the French government would have opened credits to the amount of more than 55 billion francs ($10 billions); that those credits would probably amount at the end of December to 73 billion francs ($14 billions), he would have been considered a madman and that opinion would have been supported by a quantity of arguments founded on facts. Nevertheless those expenses have been borne and the country is ready to bear others.

The experience of 1870 had not been favorable for the issue of treasury notes. It was considered that they were reserved for a special and very restricted clientele. Nevertheless the government has been able to issue about 10 billions of treasury notes ($2 billions) and continues to be able to place them easily. Persons who own capital and wish to keep it available willingly take up those notes. They have had far greater success than the bonds of the National Defence of which about 3 billions of francs have been placed.

When appeal was made to persons owning gold to come and exchange it for bank notes or National Defense notes, it was thought that in this manner 250 million francs ($50 millions) might perhaps be collected; the most optimistic doubled the figure. The amount collected has reached nearly 1,400 million francs ($270 millions).

And yet there is some in reserve. A solicitor was telling me about a farmer's wife, whose business he knows very well and who is always pleading poverty; he said that she must have in her house from 7,000 to 8,000 francs, probably in gold and silver. I know an old cook who has no direct heirs and hence no interest to enconomize and who has a little hoard to which she has added about 2,000 francs since the beginning of the war. She will listen to no talk about National Defence notes or 5 per cent rentes. She hoards up gold, silver, and bank-notes and is not the only one.

A financier who has imported a great quantity of foreign securities to France thus summed up the result of his experience:

> It is not true that France is the foremost banker of the world and owns as much capital as Great Britain or the United States. But it is the country where there is the most available capital. The capital of Great Britain is absorbed by her colonies, her navy and her trade, also her foreign enterprises. In France, there is a large amount of latent capital awaiting an opportunity.

The greater part of this latent capital has borne the effort of the war. Some yet remains. It is true that the war will have made a terrible rent in the fortune of a number of Frenchmen. There will be much to repair, to rebuild, to effect. Yet there is a certain tendency to exaggerate the damages caused by the war. There is only about 3 per cent of the surface of France which is occupied by the Germans. Men of all categories will be wanting. We do not know what will be the economic capacity of the survivors after more than two years spent in the trenches. Yet pessimists are rare. Plans are being made, and I hope our *poilus* will manifest in time of peace, the same energy that they have shown during the war.

# THE NATIONAL DEBT OF CHINA—ITS ORIGIN AND ITS SECURITY

By Charles Denby,

Former United States Counsul General in China.

The public indebtedeness of China has been incurred almost entirely during the past twenty-five years—practically all from foreign bankers, governments, and firms. In spite of her enormous national resources and gigantic wealth, the people of China have never been called upon to float a government loan, and hence only an insignificant portion of China's indebtedness is in the hands of Chinese investors. In fact China has not furnished much even of the capital that enters into companies operated within her borders.

Such undertakings as railways, mines, land development companies, traction companies, waterworks, electric light plants, etc., have usually been initiated by foreigners, have been established by foreign capital, and participation therein on the part of the Chinese has been limited.

### Reasons for Borrowing Abroad

The reasons are not far to seek. In the first place, the Chinese have for centuries distrusted their officials, and any undertaking of an official character has appealed in vain for private capital. As a rule it is only when foreigners are interested in the control of a venture that the Chinese capitalist cares to invest. This is the main reason why that country with its great natural resources, large domestic trade and keen commercial instinct has such a low standard of wealth.

Wealth to the Chinese has meant lands, houses, cattle and accumulations of silver. When a merchant made more money he bought more lands and houses, and stored more silver bullion. Chinese capitalists have not become accustomed to capitalizing their lands and their business undertakings, and issuing share certificates against them. This they have only lately learned from their association with foreigners, and this together with the distrust

of government undertakings, above alluded to, goes far to account for the small holdings of Chinese securities within the borders of China itself.

The loans of China are expressed in *taels*, or Chinese ounces of pure silver, and in nearly all cases the rate of exchange is fixed in sterling for payment, so as to avoid the fluctuations in the value of silver. The tael, consisting of a weight of silver uncoined, is the unit of value throughout China. The tael is cast into "shoes" as they are called, or blocks of silver, weighing 1, 10, 25, and 50 ounces. The Chinese ounce is about 1⅓ English oz. av., but varies in different localities. There exists a variety of taels, for example —the Haikuan or "customs" tael, in which the duties are paid; the Kuping or "treasury" tael, in which all government accounts, except duties, are tabulated, and the taels of various markets such as the Peking tael, and the taels of Tientsin, Shanghai, Canton, Hankow, and other cities—all varying slightly in weight from one another.

The exchange value between the more important taels are as follows:

| | | |
|---|---|---|
| 100 Haikuan (or customs taels) = | 101.64295 | Kuping taels |
| | 105.215 | Tientsin taels |
| | 111.400 | Shanghai taels |

The Kuping, or treasury tael, is the standard usually adopted for foreign loans, though the Boxer indemnity of 1900, hereafter referred to, was set in Haikuan taels.

The tael is not usually offered in ordinary commercial transactions, but payments are made in bank notes issued by native or foreign banks, expressed in taels, or in Mexican dollars, which have an approximate though sometimes variable tael value in every market. The banks, however, pay in the settlement of their accounts large masses of bar silver by weight, and the traveler in the inland districts often finds it necessary to take a "shoe" of so many taels of silver to the local banker, and have a portion of it cut off with a large chopper, which portion is exchanged for copper or for silver coinage.

### War and Indemnity Loans

The present outstanding foreign indebtedness of China without exception began to be incurred within the last twenty-five

years, namely, just before the war with Japan in 1894–1895. The oldest existing loan of China is in fact for taels 10,000,000—equal to 1,635,000 pounds sterling, incurred from the Hongkong-Shanghai Banking Corporation, to prosecute the war against Japan. At the termination of the war Japan exacted from China an indemnity of taels 230,000,000, which was used to place her currency on a gold basis. This loan was entirely raised from foreign sources, namely, from British, German and French banks, and from foreign governments. The total amount of these Japanese war loans, including the Japanese indemnity of taels 230,000,000, was £54,455,-000, of which £36,345,777 was outstanding in 1914, requiring annually for interest and amortization, nearly £3,000,000.

Since the Japanese war of 1894–1895 China has been free from foreign war, that is, war actually declared against a foreign power. But in 1900, a domestic rebellion in China, known as the Boxer uprising, involved that unfortunate government in the heaviest indebtedness that it has ever incurred. The Boxer uprising began in the spring of 1900, as a Chinese uprising primarily directed against the Manchu dynasty, but taking the form in June, 1900, of an anti-foreign movement, abetted by the Manchu imperial family. All of the foreign powers, namely—the United States with France, Germany, Great Britain, Italy, Japan, and Russia, despatched troops to North China to protect their nationals there resident. The officially declared view of the United States government in taking this action was that it was aiding the Chinese government to put down a domestic rebellion. The facts are, however, that the expeditionary corps of all the above powers found themselves an invading army in open warfare with the armies of China, as well as with the hordes of Boxers, congregated under their own banners.

After the restoration of order the Chinese government was called upon to pay the entire cost of the expeditions, as well as to reimburse foreigners of all nationalities in China for their losses through the uprising. The total amount of this indemnity was taels 450,000,000 which converted into sterling at three shillings per tael amounts to £67,500,000.

The annexed table shows the nations participating in this indemnity. (See Table A.)

## A. INDEMNITY AND WAR LOANS.

### TABLE TAKEN FROM THE CHINA YEAR BOOK FOR 1914.

| Date. | Title, source, etc. | Principal amount. | Interest per cent. | Price of issue. | Amount received by Chinese Government. | Term of redemption. Years. | Term of redemption. Date. | Charge (interest) for 1913. | Charge (principal) for 1913. | Principal paid off to Dec. 31st, 1913. | Principal outstanding, Dec. 31st, 1913. | Total charge (interest and principal) for 1914 | Security. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1894 | Hongkong and Shanghai Bank (War Loan) | Tls. 10,900,000† =£1,635,000 | 7 | 98 | .. | 20 | 1914 | Tls. 76,300 | Tls. 1,090,000 | Tls. 10,900,000 | Nil. | Nil. | Revenue of Maritime Customs. |
| 1895 | Hongkong and Shanghai Bank (War Loan) | £3,000,000 | 6 | 96½ | 92 | 20 | 1915 | £ 24,000 | £ 200,000 | £ 2,800,000 | £ 200,000 | £ 212,000 | Revenue of Maritime Customs. |
| 1895 | Chartered Bank of India etc. (Cassel Loan) | √£1,000,000 | 6 | 106 | 95½ | 20 | 1915 | 12,000 | 66,700 | 866,700 | 133,300 | 74,598 | Revenue of Maritime Customs. |
| 1895 | Arnhold, Karberg and Co. (Nanking Loan) | £1,000,000 | 6 | 104½ | .. | 20 | 1915 | 9,999 | 66,700 | 866,700 | 133,300 | 72,600 | Kiangsu Salt taxes and likin and revenue of Maritime Customs. |
| 1895 | Franco-Russian Government Loan (Chino-Japanese War Indemnity) | Fcs. 400,000,000 =£15,820,000 | 4 | 96½ | 94⅛ | 36 | 1931 | 439,420 | 397,250 | 5,231,748 | 10,588,252 | 836,670 | Revenue of Maritime Customs and Russian Govt. guarantee. |
| 1896 | Anglo-German Government Loan (Chino-Japanese War Indemnity) | £16,000,000 | 5 | 98¾ / 99 | 94 | 36 | 1932 | 593,407 | 364,425 | 4,314,075 | 11,685,925 | 957,404 | Maritime Customs revenue. |
| 1898 | Anglo-German Government Loan (Chino-Japanese War Indemnity) | £16,000,000 | 4½ | 90 | 83 | 45 | 1943 | 617,027 | 213,400 | 2,395,000 | 13,605,000 | 830,208 | Revenue of Maritime Customs and first charge on three salt taxes and four likin revenues. |

| | BOXER INDEMNITY: | | | | | | | £ | Amortization | | Total | £ | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1901 | A Tls. 75,000,000 à 3s† | =£ 11,250,000 | 4 | .. | .. | 39 | 1940 | 574,425** | | | charges | 574,425 | Balance of revenues of |
| 1901 | B Tls. 60,000,000 à 3s† | =£ 9,000,000 | 4 | .. | .. | 39 | 1940 | 520,470** | begins 1915[1] | | outst'nd'g | 520,470 | Maritime Customs after |
| 1901 | C Tls. 150,000,000 à 3s† | =£ 22,500,000 | 4 | .. | .. | 39 | 1940 | 900,000 | begins 1916[2] | | £ | 900,000 | payment of pre-existing |
| 1901 | D Tls. 50,000,000 à 3s† | =£ 7,500,000 | 4 | .. | .. | 39 | 1940 | 300,000 | begins 1932[3] | | 112,961,212 | 300,000 | charges, Native Customs revenues at open ports, and |
| 1901 | E Tls. 115,000,000 à 3s† | =£ 17,250,000 | 4 | .. | .. | 39 | 1940 | 690,000 | begins 1932 | | 10s | 690,000 | salt gabelle. |
| 1905 | Hongkong and Shanghai and Deutsch-Asiatische Banks (Exchange Adjustment of Indemnity)†* | £ 1,000,000 | 5 | 97 | .. | 20 | (1925) 1915 | 6,250 | £ 50,000 | £ 850,000†† | 150,000 | 57,750 | Peking Octroi, and Shansi likin. |

† Shanghai currency at 3s per Tael.
** Fixed annual charge for amortization and interest which began in 1902 on "A" and 1911 on "B."
[1] When fixed annual charge for amortization and interest will be £1,407,600.
[2] When fixed annual charge for amortization and interest will be £480,075.
[3] When fixed annual charge for amortization and interest will be £2,319,925 10s.
†* The following table shows the manner in which the indemnity was divided:—

| | Proportion per cent. | Haikuan Taels. | | Foreign Currency. | |
|---|---|---|---|---|---|
| Germany | 20.015 67 | 90,070,515 | Mks. | 278,166,423.93 | |
| Austria-Hungary | 0.889 76 | 4,003,920 | Kr. | 10,394,092.40 | |
| Belgium | 1.885 41 | 8,484,345 | Fr. | 31,816,293.75 | |
| Spain | 0.030 07 | 135,315 | Ps. | 507,431.25 | |
| United States | 7.319 79 | 32,939,055 | Dol. | 24,440,778.75 | (of which $10,785,286.12 was remitted in 1908) |
| France | 15.750 72 | 70,878,240 | Fr. | 265,793,400.00 | |
| Great Britain | 11.249 01 | 50,620,545 | £ | 7,593,080.19 | |
| Portugal | 0.020 50 | 92,250 | £ | 13,837.17 | |
| Italy | 5.914 89 | 26,617,005 | Lire | 99,803,768.75 | |
| Japan | 7.731 80 | 34,793,100 | Yen | 48,950,891.70 | |
| Holland | 0.173 80 | 782,100 | Fl. | 1,404,651.60 | |
| Russia | 28.971 36 | 130,371,120 | Roubles | 180,084,021.44 | |
| Norway and Sweden | 0.013 96 | 62,820 | £ | 9,432.00 | |
| Sundry | 0.033 26 | 149,870 | £ | 22,450.10 | |

†† £500,000 additional paid off in 1907.

## THE BOXER INDEMNITY

This debt China agreed to pay in a term of 39 years, with interest at 4 per cent. The amortization began January 1, 1902, to finish at the end of 1940.

A single bond for the entire sum was issued to the Doyen of the diplomatic corps at Peking, then the German minister, Mr. von Mumm. This bond was subsequently converted into fractional bonds and payments on these bonds are now made to an international commission of bankers at Shanghai which divides such payments among the interested parties. These payments are made by the Chinese government according to the table which was made a part of the Peace Protocol of 1901. The total charges for this indemnity—principal and interest, are £112,961.212, 10 shillings, and the fixed charge for 1916 was taels 24,483,800, or £2,772,500.

The security pledged for the "Boxer indemnity," as it is called, and for the Japanese war and indemnity loans above referred to is the revenue of the Imperial Maritime customs, supplemented in some cases by likin or internal revenue taxes, salt taxes, and the octroi of cities.

This leads to an inquiry as to what these various pledged revenues consist of.

## THE REVENUES OF THE CHINESE GOVERNMENT

The imperial maritime customs constitute the chief, and until the reorganization within the last three years of the government salt tax, the most reliable source of income of the Chinese government. The maritime customs service is organized under foreign administration, and is charged with the collection of all of the imports duties, levied by China on goods imported from abroad, and certain other taxes on foreign ships and goods. This customs service had its origin in 1853, when the city of Shanghai was menaced by the great Taiping rebellion, and the local government ceased to function. The consuls of the United States and of Great Britain collected the import duties on account of the central government. From that time on the "customs service," as it is known, has continued to collect all import duties, and its scope has been further enlarged by charging it with the collection (1) of duties on goods carried in foreign bottoms in the coast trade; (2) tonnage

duties on shipping; (3) all duties on goods imported which are carried further inland and are subject to fixed duties on the way; (4) the likin or special tax on imported opium. This service collects an annual revenue of taels 40,000,000, equal at the approximate present rate of taels for United States dollars, to about $30,-000,000. The actual rate varies daily with the quotation for bar silver.

This revenue is honestly collected and actually devoted to the purpose for which it is supposed to be devoted. It is largely appropriated at present for the service of the loans and indemnities above referred to, and it is also charged with the maintenance of the foreign diplomatic and consular service of China. As, however, these loans are being gradually wiped out by amortization, and as the revenues of the customs service will increase with the normal increase in trade, the customs service could offer excellent security for any future loans, the requirements of which should not exceed its revenue.

The likin or internal revenue tax is far less satisfactory as a security for loans. This was originally a war tax devised by the Chinese government to meet its emergencies during the Taiping rebellion. It is a tax levied at barriers established at places throughout the interior through which goods in transit must pass. It is subject to great abuse and corruption. It is usually wholly or in part evaded—often it is unjustly increased—and the proceeds are rarely properly accounted for. Hence the foreign powers have long insisted that the likin tax be abolished, and China has repeatedly undertaken that this should be done. The tax, however, continues among the sources of Chinese revenue. It was estimated that in 1912 it produced about taels 24,389,337, something over $18,000,-000, at the rate of $.75 gold per tael.

In spite of the general foreign disapproval of the likin taxes, they are not infrequently included in the revenue pledged for railway and other general loans. The inclusion of these taxes as security for the Boxer indemnity is believed to have a special explanation; the foreign powers having probably exacted a pledge of this revenue with a view to controlling it, for the purpose of eventually suppressing it.

The octroi or levy of taxes on merchandise upon its introduction into Chinese cities is subject to the same criticism as the likin taxes. Neither can be regarded as satisfactory security for a loan

of any duration, and it is certain that upon the reform of China's general scheme of taxation, which the commercial world hopes for, both will be abolished. Much favorable comment was excited by the declaration of the Republic of China upon its coming into existence in 1913, that the likin taxes should be abolished.

## Chinese Railways Loans

The second large group of Chinese government debts covers the railway loans of China, which amounted up to 1914 to £52,-157,000, of which £1,402,892 have been repaid, leaving somewhat over £50,000,000 outstanding. All of these loans with the exception of £2,300,000 contracted in 1898, of which nearly £600,000 has been repaid, and the Belgian loan of 1898 for £4,500,000, which has been repaid in full, were contracted since 1900.

The annexed table taken from the China Year Book of 1914, the last edition published, gives the details of these loans. (See Table B.)

Redemption payments on these began or will begin at various times from 1914 to 1920. It is to be noticed that the security pledged for these railways loans is the railway itself with the government's guarantee, and in some cases, certain taxes in addition. As a matter of fact, the railways of China have been found to be ample security. The figures for six months ending December 31, 1914, show that China's fourteen main railway lines all were run at a profit, showing a total net revenue of $2,300,000—this in spite of the depressing influence of the European war, which has greatly cut down the carriage of ocean-borne goods. The 1914 revenues were much lower than in the preceding year. These roads all pay, and if discreetly managed will continue to pay. It is probable that the accuracy of control of finances demanded by the foreigners who have advanced money on them has compelled a careful management—at variance with the usual Chinese pratice. There is no knowing how soon the principle of "squeeze," the arch enemy of Chinese finance, would bring about disorders, were it not for severe foreign auditing.

## An Injury to American Prestige

Among the railway loans of China we must note one of particular interest to Americans; the Hankow-Canton railway contract

for £1,100,000. The circumstances which gave rise to this loan were as follows:

An American syndicate had secured the contract to build a line from Hankow to Canton, a distance of 700 miles; the first survey had been made, the road promised in every way to be profitable, and the American holders of the stock found opportunities to sell part of their holdings abroad. Among others the King of Belgium, whose nationals had signed a contract to build a line from Hankow to Peking, became a heavy buyer. It is probable that he was influenced to buy by the natural desire to have some standing in the control of a road destined to be so closely connected in operation with the Belgian owned line.

It seems, however, that the government of the British colony at Hongkong had never been pleased with the prospect of railway construction in the vicinity of that colony falling into the hands of Americans, and the Hongkong authorities represented to the Chinese that the sale of shares to the King of the Belgians was a violation of the American contract which provided that the line should not be ceded to other than Americans. The Chinese government probably had no feelings whatever on this subject, but it suited the purpose of the Hongkong government, backed by some Chinese of influence, to represent that there was such bitter feeling in the country traversed by the road over the bad faith of the American concessionaries that the Americans would not be permitted to continue the construction thereof. This representation coupled with an offer of a handsome profit on the outlay led American capitalists to sell back their concession to the Chinese. When it was realized that the money which China paid was actually provided by Hongkong, the true nature of the transaction became apparent. The American holders of the concession had given up a valuable franchise because British policy conflicted with it, and incidentally American prestige received a blow from which it has not yet recovered.

Up to the present time China has not tried to finance her roads by the selling of shares. She has always borrowed on mortgage bonds, which she hastens to pay up, thus eating up the earnings and showing small profits on operation. With the actually large earning power of the Chinese railways, large stock dividends could easily be declared, which would increase the value of the stock so

## B. RAILWAY LOANS.

| Date. | Title, source, etc. | Principal amount. | Interest per cent. | Price of issue. | Amount received by Chinese Government. | Term of redemption. Years. | Term of redemption. Date. | Charge (interest) for 1912. | Charge (principal) for 1912. | Principal paid off, Dec. 31st, 1912. | Principal outstanding on Dec. 31st, 1912. | Total charge (interest and principal) for 1913. | Security. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | £ | | | | | | £ | £ | £ | £ | £ | |
| 1898 | British and Chinese Corporation Loan for Imperial Railways in North China | 2,300,000 | 6 | 97 | 90 | 45 | 1944 | 92,000 | 57,000 | 517,500 | 1,782,500 | 146,626 | Government guarantee and revenues of railway. Railway to be handed over in case of default. |
| 1898 | Franco-Belgian Loan for Peking-Hankow Railway | 4,500,000 | 5 | .. | 90 | 30 | 1928 | Redeemed in 1908 | | | | | |
| 1902 | Russo-Chinese Bank Loan for Shansi Railway (floated in France) | 1,600,000 | 5 | .. | 90 | 30 | 1931 | 80,000 | (First instalment due 1915) | | 1,600,000 | 80,000 | Government guarantee and revenue of railway. |
| 1903 | Franco-Belgian Loan for Kaifengfu-Honan Railway | 1,000,000 | 5 | .. | 90 | 30 | 1934 | 50,000 | (First instalment due 1915) | | 1,000,000 | 50,000 | Revenue of railway. |
| 1904 | British and Chinese Corporation Loan for Shanghai-Nanking Railway | 2,250,000 | 5 | 97½ | 90 | 50 | 1953 | 145,000 | (To be redeemed in full 1953) | | 2,900,000 | 145,000 | Profits of and mortgage upon the railway. |
| 1907 | British and Chinese Corporation Loan for Shanghai-Nanking Railway | 650,000 | 5 | 100 | 95½ | 47 | 1953 | | | | | | |
| 1905 | Peking Syndicate Loan for Taokow-Chinghua Railway | 700,000 | 5 | .. | 90 | 30 | 1935 | 35,000 | (First instalment due 1916) | | 700,000 | 35,000 | Government guarantee and revenue of railway. |
| 1905 | Hongkong Government Loan for redemption of Canton-Hankow Railway Contract | 1,100,000 | 4½ | .. | 100 | 10 | 1915 | 14,850 | 110,000 | 880,000 | 220,000 | 119,900 | Opium taxes of Hupeh, Hunan, and Kuangtung. |
| 1907 | Franco-Belgian supplementary Loan (Kaifengfu-Honan Railway) | 640,000 | 5 | .. | 90 | 25 | 1932 | 32,000 | (First instalment due 1915) | | 640,000 | 32,000 | Government guarantee and revenue of railway. |
| 1907 | British and Chinese Corporation Loan for Canton-Kowloon Railway | 1,500,000 | 5 | 100 | 94 | 30 | 1937 | 75,000 | (First instalment due 1920) | | 1,500,000 | 75,000 | Profits of and mortgage upon the railway. |

| | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1906 | Anglo-German (Imperial Chinese Government 5% Tientsin-Pukow Railway Loan)* | 3,000,000 | 5 | 98½ | 93 | 30 | 1938 | 250,000 | (First instalment due 1919) | 5,000,000 | 250,000 | First charge upon likin and internal revenues of Chihli, Shantung, and Kiangsu. |
| 1909 | Anglo-German (Imperial Chinese Government 5% Tientsin-Pukow Railway Loan)* | 2,000,000 | 5 | 100 | 93 | 29 | 1938 | | | | | |
| 1908 | British and Chinese Corporation Loans for Shanghai-Hangchow-Ningpo Railway | 1,500,000 | 5 | 99 | 93 | 30 | 1938 | 75,000 | (First instalment due 1919) | 1,500,000 | 75,000 | Surplus earnings of Peking—Mukden railway. |
| 1908 | Anglo-French Loan for redemption of Peking-Hankow Railway | 5,000,000 | 4½ / 5 | 98 | 94 | 30 | 1938 | 250,000 | (First instalment due 1919) | 5,000,000 | 250,000 | Sundry taxes of Chekiang, Kiangsu, Hupeh, and Chihli. |
| 1908 | Japanese Loan for Kirin-Changchun Railway | Yen 2,150,000 à 10 = £215,000 | 5 | .. | 93 | 25 | 1934 | 10,750 | (First instalment due 1914) | 215,000 | 10,750 | Revenue of the railway. |
| 1909 | Japanese Loan for Hsinmintun-Mukden Railway | Yen 320,000 à 10 = £32,000 | 5 | .. | 93 | 18 | 1927 | £1,492 10s | £1,797 12s £ 5,392 16s | £ 26,607 4s | £ 3,127 19s | Revenue of the railway. |
| 1910 | Anglo-German (Tientsin-Pukow Supplementary Loan) | 3,000,000 | 5 | .. | .. | 30 | 1940 | 240,000 | (First instalment due 1921) | 4,800,000 | 240,000 | First charge upon likin and certain internal taxes of Chihli, Shantung, Kiangsu, and Andhui. |
| 1910 | London, City, and Midland Bank (Yuchuanpu Bonds for Peking-Hankow Railway expenses) | 450,000 | 7 | 108 | 100 | 10 | 1920 | 31,500 | (First instalment due 1916) | 450,000 | 31,000 | Government guarantee. |
| 1910 | Peking-Hankow Railway redemption Loan (Yokohama Specie Bank) | 220,000 | 7 | .. | 97½ | 10 | 1920 | 15,400 | (First instalment due 1915) | 210,000 | 15,400 | .... |
| 1911 | Yuchuanpu Loan (Yokohama Specie Bank) for Peking-Hankow Railway expenses | 1,000,000 | 5 | .. | 95 | 25 | 1936 | 50,000 | (First instalment due 1922) | 1,000,000 | 50,000 | Government guarantee and Tribute Grain Conversion Tax of Kiangsu. |
| 1911 | Hukuang Railways Sinking Fund Gold Loan (Four Nations Loan)† | 6,000,000 | 5 | .. | 95 | 40 | 1951 | 300,000 | (First instalment due 1921) | 6,000,000 | 300,000 | Hupeh and Hunan salt and likin revenues and Hupeh rice tax. |
| 1912 | Nanchang-Kiukiang Railway Loan (East Asia Industrial Co.) | 500,000 | 6½ | .. | 100 | 15 | 1927 | 32,500 | (First instalment due 1922) | 500,000 | 32,500 | .... |
| 1912 | Belgian-Lanchow Railway Loan Lung-Tsingu-Hai | Fcs. 250,000,000 = £10,000,000 | 5 | .. | .. | 40 | 1952 | .. | .. | .. | .. | Government guarantee and mortgage on railway. |
| 1913 | Sinyang-Pukow Railway (British and Chinese Cpn.) | 3,000,000 | 5 | .. | 95 | 40 | 1953 | .. | .. | .. | .. | .... |

* Of these loans £1,850,000 was issued by the Hongkong and Shanghai Bank and £3,150,000 by the Deutsch-Asiatische Bank.
† British, French, German, and American Group.

that it could be sold at par or above, and thus meet the needs for capital on better terms than selling mortgage bonds, and without the necessity of periodic redemption.

## GENERAL LOANS OF CHINA

The general loans of China comprise a variety of issues with a variety of securities. Section C of the annexed table gives the dates and details of some of these loans. In addition there must be noted a long list of small loans obtained from the domestic market, through Chinese official banks, and through various ministries, etc. These loans are short-term debts, to be dealt with in the course of current business, and can scarcely by regarded as part of China's national debt.

The total of these debts according to a table compiled by the Minister of Finance in 1913 was:

| | | |
|---|---|---|
| Domestic short term debts, due by the Central Government | | |
| | Mexican | $47,475,145 |
| Foreign short term debts due by Central Government | | |
| | Mexican | $28,890,153 |
| Total | Mexican | $76,365,298 |

which at $.50 per Mexican dollar equals $38,182,649.

These short-term debts are generally unsecured and are payable out of the revenues of the Chinese government, not otherwise applied, such as the land tax, shop taxes, and other direct taxes.

It is difficult to obtain reliable data as to the revenues of the Chinese government from these various kinds of taxation. There is reason to believe, however, that large as these revenues are, if honestly collected and accounted for, they would produce enormous sums above the present returns. One of the most important of these sources which has recently been pledged as security for loans by foreigners is the salt tax. In 1912 the Chinese government negotiated with a group of foreign bankers, English, German, French, Russian, Japanese, and American, a reorganization loan agreement to handle practically all of China's indebtedness. This group was known as the "Six-Power group," until the American bankers withdrew at the beginning of the Wilson administration, leaving a "Five-Power group." The loans made by this group were secured not only by the revenues of China not otherwise

C. GENERAL LOANS.

| Date. | Title, source, etc. | Principal amount. | Interest per cent. | Price of issue. | Amount received by Chinese Government. | Term of redemption. Years. | Term of redemption. Date. | Charge (interest) for 1912. | Charge (principal) for 1912 | Principal paid off to Dec. 31st, 1912. | Principal outstanding on Dec. 31st, 1912. | Total charge (interest and principal) for 1912. | Security. |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | £ | | | | | | £ | £ | £ | £ | £ | |
| 1900 | Anglo-Danish Telegraph Loan ... | 210,000 | 5 | .. | .. | 30 | 1930 | .. | .. | .. | .. | .. | Shanghai-Taku Cable. |
| 1901 | Anglo-Danish Telegraph Loan ... | 48,000 | 5 | .. | .. | 29 | 1930 | .. | .. | .. | .. | .. | Chefoo-Taku Cable. |
| 1911 Mar. | Japanese Loan to the Ministry of Communications.............. | 1,000,000 | 5 | 95 | .. | 25 | 1936 | 50,000 | (First instalment due, 1921) | | 1,000,00 | 50,000 | Revenue of Peking-Hankow Railway & Kiangsu Grain Commutation Revenue. |
| 1911 April | Telegraph Loan (Eastern extension and Great Northern Telegraph Companies)............ | 500,000 | 5 | .. | .. | (36 half-yearly instalments) | | 23,957 | 27,776 | 41,664 | 458,336 | 50,691 | Certain Telegraph receipts. |
| 1911 | Currency Reform and Industrial Development Loan (Four Nations Group).................. | 10,000,000 | 5 | 95 | 95 | (Not yet floated) | | An advance of £400,000 for Plague and other expenses in Manchuria was made on June 1, 1911. | | | | | Tobacco, wine, production and consumption taxes of the three Manchurian Provinces and the new Salt Surtax of the whole of China. |
| 1912 (Feb. to June) | Advances from Sextuple Group | Tls. 12,100,000 | 5 | .. | .. | | (Covered by delivery of Treasury Bonds to be repaid from projected Reorganization Loan.) | | | | | | |
| 1912 (Mar.) | Advances from the Belgian Syndicate........................ | £ 1,250,000 | .. | .. | 9 | | (Part of projected loan of £5,000,000 to £10,000,000 now cancelled) | | | | | | Net income and property of Peking-Kalgan Railway. |
| 1912 | Loan from Messrs. C. Birch Crisp and Co....................... | 5,000,000 | 5 | 95 | 89 | 40 | 1952 | .. | (First instalment due 1923) | | 5,000,000 | 250,000 | Surplus Revenues of Salt Gabelle. |

applied, but it was expressly stated that the salt revenues should serve the loan, and that the Chinese government should reorganize the salt administration for this purpose. To this end the collection of the salt tax was placed under foreign control. The results have been astounding. The net receipts from the salt taxes in 1914 were over $29,000,000 United States currency, and exceeded the total revenue of the Imperial Maritime customs. Heretofore one third of this sum would have been considered as exaggerated, but it is confidently expected the salt revenue will even exceed these figures for the future.

The salt tax of China requires some explanation. The production of salt is controlled by the Chinese government, which issues permits to produce salt to a group of salt merchants, to each of whom it is permitted to produce a certain specified quantity, and for this privilege he pays to the government a heavy tax. The consumption of salt in China is not per capita larger than in other countries, and the supply from the mountains and the sea is practically unlimited, but the price rules high because the quantity permitted to be marketed is limited. Under the old Chinese régime many abuses crept into the collection of the salt tax. Producers marketed more than their allotment, and paid short duties thereon. Likewise, the clandestine production enormously increased. Under the severe scrutiny of the agents of the bankers, who had loaned on this revenue, these abuses were corrected, and to this only is the greater income from the salt tax to be attributed.

### The Land Tax of China

The land tax of China has received heretofore not much attention as possible security for foreign loans. It is estimated that in 1912 the actual receipts from this source by the government were in excess of taels 52,000,000 (which at $.75 per tael equalled nearly $40,000,000), but the actual amount collected from the people was seven or eight times that sum. For an American loan now under consideration it has been proposed that the security shall be the land tax, and that this tax, as in the case of the salt tax, shall be collected by foreigners. There is no doubt as to the enormous increase in China's revenue if this could be done, but there will be great difficulty in inducing Chinese officialdom to part with the control of a source of income so fruitful in illicit gain.

### FUTURE NEEDS FOR CAPITAL

The needs of China for capital must increase as her internal resources, means of communication, etc., are further developed. Additional capital will be needed for railway development, and for other interior means of communication. There were at the end of 1914 in China, about 6,000 miles of railroads in operation, 2,300 miles under construction, and about 9,000 miles further projected.

This in effect will provide only the main lines of China. The immense local development of railroad construction to connect localities with the main line, and the main lines with one another, must be anticipated.

Highways in China are also destined in the next two decades to demand great development, and this will call for, in fact, is already calling for foreign loans. Outside of the five cities of Shanghai, Tientsin, Peking, Hankow, and Tsingtau, there are no roads suitable for automobile traffic. There are in Shanghai about 150 miles of automobile roads, about 20 miles in Peking, 60 miles in Tientsin; in the suburbs of Tsingtau some miles of country road have been constructed under German influence, and at Peking a motor road, about 12 miles long, connects the city with the summer palace. It is to be noted that for suburban road construction in Peking, two American groups, of which the writer controls one, have contracted with the Chinese government to advance the needed money. This one item of road construction promises a great demand for foreign loans, which will approximate that created by the railways. Motor roads through fertile populous areas will afford good security for foreign loans, especially if the major part of the cost of construction is borne by local taxation as the Chinese authorities propose.

Road construction will lead inevitably to a wide internal development, which will call for heavy foreign advances. If China could borrow for this development as much as she owes for war loans, and indemnities, stupidly incurred, she could put her people far along the road to prosperity.

There is one feature of China's loans that has escaped general attention. China is going to need foreign money in a pronounced degree after the war. To secure this money, she is going to offer favorable contracts, concessions, etc., to representatives of foreign banks and industrial groups. The past financial history of China

leads to the belief that these representatives will be chiefly from those countries now at war in Europe. England, France, Italy, Belgium, Germany, will have no money to lend, but to hold their standing in China, they will neglect no means of finding it. Europe will not readily allow a status in China which it has taken half a century to create to be menaced by a lack of funds. The United States will be called upon to provide these funds. It will then be the duty of American financiers to consider whether to lend money to Europeans to enable them to exploit the China field, or whether it would not be wise to exploit that field themselves.

China affords a brilliant future for the merchant and for the contractor, if they come sufficiently backed financially. The returns will be certain. China in all cases can give satisfactory security for all she borrows. Back of all is the guarantee—better than security—the good faith of the Chinese government which has never yet repudiated a debt.

# THE BRITISH TREASURY AND THE LONDON STOCK EXCHANGE

By W. R. Lawson,

Author of *British War Finance*, London, Eng.

In after years the effects of the European war will be thoroughly discussed from many different points of view. Its military, its political and its financial bearings will be vehemently canvassed by critics of many opposite opinions and sympathies. For most of these controversies the proper time has not yet arrived—it is hardly even in sight. Some of them may not assume definite form for years to come. Prolonged and trying as the war has been, the reconstruction of a ruined Europe which has to follow may be an even more tedious task. As yet the orgy of war havoc has not run its course and Heaven alone knows when or where it is to stop.

Gloomy as the outlook is, the financiers may at least congratulate themselves that they can see a little further ahead than either the soldiers or the politicians. What the armies of the future are to be, the most advanced military experts have not yet begun to speculate. What the politicians of the future are to be is too bewildering a theme for the ordinary electioneer. He feels sure that they will be in many respects the antipodes of the present generation. But important as these questions may be, there are others which will have to take precedence. The most urgent of all will be the financial problems. Nowadays, finance is the beginning and the end of war. Within forty-eight hours after the British Cabinet declared itself at war with Germany a huge vote of credit was asked of the House of Commons and a vote of credit will probably be the closing act of the world tragedy.

## Financial Effects of War

The financial effects of war develop much more rapidly and distinctly than the military or the political effects. They begin on the threshold and they go on developing continuously to the end. London has been the center of these, as of all ordinary financial developments. It says much for the elasticity and adaptability of

London's financial machinery that they should have proceeded so smoothly and quietly. For more than two years the city has been undergoing a noiseless form of earthquake. The pre-war organization has fallen to pieces bit by bit and substitutes have had to be improvised for the broken parts. Lombard Street gradually wound up its normal business in commercial paper and diverted the greater part of its floating capital into British government securities.

From bankers' bills and acceptances it turned its attention to treasury bills, exchequer bonds and war expenditure certificates. Even its nightly balances were no longer lent in the street but paid into the Bank of England to the government account.

Side by side with the monetary revolution and interwoven with it a widespread commercial and industrial transformation has been going on. As munition works, factories, shipbuilding yards, steamers, hotels and going concerns of every kind were taken over by the government, the normal circulation of capital became more and more disturbed. A thousand streams hitherto separate and distinct became merged into one great river. Thousands of firms previously doing their own financing and pursuing their own line of business were converted by a stroke of the pen into state contractors. They had to place themselves at the beck and call of government officials and to act as agents of the Admiralty, the War Office, the Ministry of Munitions or some other public department. Mr. Lloyd George, when Minister of Munitions, boasted quite truthfully that he was by far the largest employer of labor in the United Kingdom.

## The Problem of Foreign Exchange

Every one of these innumerable changes had a corresponding effect on the financial machinery of the country. Some of them lightened the strain upon it, but most of them increased it. Home trade and foreign trade each produced its own problems and difficulties all converging, however, into the grand problem of foreign exchange. How to maintain the stability of the pound sterling was now the supreme question for British bankers and financiers. Quite naturally, though very unexpectedly even to banking experts, this became the crux of British war finance. If Mr. Lloyd George or Mr. McKenna had many sleepless nights at the Treasury, as doubtless both of them had, it will be safe to say that more of them

were due to sterling exchange than to either war loans or war taxes. The latter gave them much less trouble than might have been apprehended. The first two war loans were triumphs of patriotic enthusiasm and lavish advertising. The treasury bills, exchequer bonds, war expenditure certificates, and "£ for 15/6" cards were taken up by hundreds of millions sterling. But useful as they were for meeting domestic expenditure they had the great drawback of not being available for foreign liabilities—unless of course at an increasing discount.

This dilemma, though it was one of the most certain incidents of war finance, had not been foreseen either at the Treasury or in the city. So utterly unexpected was it that in the first months of the war exchange were very much against New York and in favor of London. The most Gilbertian mission from one financial center to another ever known was that which the British Treasury sent to the United States in the autumn of 1914 to arrange for the rehabilitation of the dollar. From purely temporary causes—New York blamed chiefly the British moratorium while London protested that the moratorium was never strictly enforced against American credits—the dollar had dropped to an alarming discount in relation to sterling. There was no real occasion for the British Treasury to trouble itself on that score. It might from the beginning have been left—as it had to be at the end—to the American bankers who were responsible for it and understood it much better than any foreign visitor could possibly do.

It is perfectly clear now that in the exchange scare of 1914 the British Treasury should have done exactly the reverse of what it did. Instead of concerning itself about a slump in the United States dollar, which the progress of the war was bound to remedy and possibly drive to the opposite extreme, it should have taken the utmost advantage of the rare opportunity thus offered of buying or borrowing from the United States on the most favorable terms. As it happened it did its best to turn the American exchange against itself and then discovered that it must make huge loans and purchases when the dollar had risen from a considerable discount to an equally considerable premium. This deplorable lack of foresight had the most varied and far-reaching consequences. It not only made an enormous addition to the war burdens of the unfortunate British taxpayer, but it upset the whole course of business between

the two countries. Nor did it stop at ordinary business. In the end the British Treasury was forced by it into a roundabout system of forced loans for which financial history offers no parallel.

## Mobilization of Securities

This was the commandeering of investments—at first American dollar securities and then Canadians. Dark hints have been thrown out that the operation may be carried still further and that no class of British investment can be considered safe from it. Obviously, this is a panic policy which nothing less than the safety of the state would justify. It is also a one-ideaed policy. For the moment nothing is thought of by its authors but the maintenance of sterling exchange. The reaction which must inevitably follow when hundreds of millions' worth of dollar securities have been transferred from London to New York, and when the financial relations of the two cities have been turned right around—London becoming the debtor and New York the creditor center—is completely ignored. Foreign exchange dealers will find it very difficult to realize that a great stream of interest and dividend payments no longer flows eastward from New York, while a new stream of such payments has started flowing from London westward.

In the entire history of international finance there has never before been such a wholesale migration of negotiable securities from one country to another as that which the British Treasury has been at work upon for the past two years. As yet we can only see its preliminary effects. That it has been the principal means of steadying sterling exchange will not be disputed. Compared with the hundreds of millions sterling which have crossed the Atlantic in the form of securities, the shipments of gold from Canada to New York have been a mere flea bite. Nevertheless, the combined effect of both gold and securities has merely sufficed to hold up exchange at its reduced level of $4.76. Apparently that was all the financial experts in charge of the operation thought it advisable to attempt. They have had to shut their eyes to the thought of what may happen when their dollar securities are exhausted.

## Primary Effects of the Treasury Policies

In attempting to forecast the ultimate effect of this wholesale exodus of dollar securities we are checked on the threshold by the

profound uncertainty which prevails in the city as to its actual magnitude. The Treasury always professes to be agreeably surprised at the great volume of bonds and stocks sent in, but never the slightest indication is given of its actual amount. The only clues to it ever forthcoming—and they are the vaguest kind—we owe to the New York press. Occasionally we read in a New York cable of an Atlantic liner arriving with $25,000,000 of securities. At other times we are told that Wall Street has been weak on apprehensions of selling on behalf of the British Treasury. But about the migration as a whole we are allowed to know as little as about the fabulous munition contracts which the dollar securities are intended to pay for. An all round game of secrecy is being played by the Treasury and its city advisers.

There are, however, some effects which cannot be kept secret. It is impossible to conceal the fact that our American market has been nearly killed by losing the best part of its stock in trade. The banks, the trust companies, the insurance offices and private investors who used to be always turning over their American stocks have been forced out of them into war loans, Treasury bills, exchequer bonds or some other form of government credit. They have been driven out of what was for years the largest and freest market in the House into a practically new and untried market. Politicians continue to speak about the consol market as if it were still the same gilt edged institution as of old, but seen from the inside it is something very different. It has risks and vicissitudes before it which old-fashioned consol dealers never dreamed of. There is no saying what games the politicians may play with it, or how long it may be able to bear up against their emergency expedients.

Still less can we foresee how our future war taxes are to hamper for generations to come the competitive power of the nation in international trade, or how far the hybrid socialism which the war has imposed upon us is afterwards to be carried. An early return to pre-war conditions is out of the question. It is not even expected that the state will stand still where it is today. A further advance in the direction of nationalization is considered inevitable, and every fresh step taken on that slippery path will mean a new outpouring of state securities. The railways will probably be kept for some time under the existing war régime and out of it may emerge a new administration on the lines of the Port of London

Authority. If the railways go the collieries are pretty sure to follow and with the two key industries nationalized the state will be the principal owner as well as principal debtor. All British securities will be directly or indirectly socialized. As to whether or not that is to improve their quality there may be many different opinions.

At the close of the war it will be found that the British market has produced not only the largest quantity but the greatest variety of war loans on record. Its unfunded debt in particular will be a lasting wonder for the financial world. That over 1,200 millions sterling of short term securities could be sold over the counter as it were within half a year will seem to future ages incredible. But a much greater feat has yet to be accomplished—namely, the funding of this enormous mass of floating debt. When that tremendous task has been accomplished the three regular war loans—two British and the Anglo-French issue—will have to be renewed in some form or another. Evidently the British Treasury has several years of tough work ahead of it.

## The Ultimate Effects

So much for the primary effects of the war on British investments. But there will be secondary and still more remote effects to consider also. How, for example, is British credit likely to come through the severe ordeal confronting it? On this point London bankers appear to be universal optimists. British credit, they say, stands as high as it ever did and doubtless in a superficial sense it does. But that is not the whole question. Not the quality but the strength of the national credit is what will tell in after the war reorganization. Will the financial resources of the country, viewed in their largest and broadest sense, be unimpaired? Only the most inveterate optimists can think so. Even unimpaired strength would not suffice for the new situation with its enormously increased strains and burdens. There will not be real maintenance of power unless it has grown equally with the work to be done.

Every belligerent nation and some neutrals as well will emerge from the war in a severely damaged financial condition. In the process of pulling themselves together they will have to create incalculable quantities of new securities which will have to be very cautiously handled. It will be impossible to raise them all at once to the pre-war level of gilt edged securities. There will be many

readjustments to make and many reorganizations to carry through before any approach to pre-war conditions becomes possible. In this purgatorial period investment values may be held down by dear money, new loans and higher working costs. Material damage has been done during the war to nearly every financial system in Europe and in some cases it may be very prolonged. So many unexpected emergencies had to be faced and so many novel devices had to be tried that all kinds of dislocations followed. These not only affected the conduct of the war but they are leaving behind them the seeds of future trouble.

By a not unusual irony of fate it may turn out that the damage done has been greatest where the greatest pains were taken to avert it. London, recognizing its exceptional position in the financial world and the responsibilities which such a position entailed on it, did its level best to foresee all possible dangers and provide against them. Whether in its excessive zeal and its over-anxiety it always acted wisely is now generally questioned. No human government could possibly have solved offhand all the financial and commercial problems which crowded in on the Asquith Cabinet from the moment that war was declared. But the ministers being for the most part lawyers had unlimited confidence in themselves and no difficulty came amiss to them. Very soon they had so many puzzling questions on hand that while they were grappling with a comparatively unimportant one something much more serious was allowed to drift into disaster. One case in point which American readers may easily recall is the belated Anglo-French loan of 1915 which was put off until a phenomenal slump in sterling exchange rendered it doubly difficult to negotiate.

## The War and the Investment Markets

In attempting to answer the question which has been put to me by the editors of this war number of *The Annals* as to the influence of the war on the investment market, I should first of all premise that a broad view must be taken of war finance. It varied widely both among neutrals and belligerents. It was handled very differently in various countries and by various governments. The financial conditions in Great Britain which had world-wide liabilities to protect not only for itself but for half a dozen Allies were necessarily far heavier than those of the Allied states which Great Britain

helped to finance. It needs no argument that the British task was in this respect the heaviest of all. Any finance minister, however skillful and courageous, might well have shrunk in despair from the innumerable risks and perils which Mr. Lloyd George had to face at the outset of the war. It has been sardonically remarked that his comparative ignorance of city conditions in those fateful days saved him from losing his head. Had he known more he might have been less ready with his Treasury guarantees to the bill market, the banks and other institutions.

The sensational measures with which the financial campaign opened, however, were justified by success and that may be held to exempt them from further criticism. What is of practical interest now is the complete reversal that afterwards took place in the official policy. From excessive freedom and liberality the government rushed to the opposite extreme of restriction and prohibition. This later policy was afterwards pursued right along with very little relaxation but rather with increasing severity. The ostensible object of it was twofold—first, to conserve our financial resources for the service of the war; and second, to prevent money or securities reaching the enemy. The fact of its having been belated may account to some extent for the feverish eagerness with which it was at last applied. Its principal victim was the stock exchange.

### Effects of Closing the Stock Exchange

From July 29, 1914, when the stock exchange was closed until the following January when it was reopened business had to be carried on in the street. Uncomfortable and inconvenient as that was, especially in the cold and wet winter months, it had its compensations. Dealings were practically free and a considerable amount of business was done between offices by telephone or messenger as well as in the street. The committee issued new regulations almost daily but they were not as a rule restrictive. They were generally intended to solve difficulties or to remove obstacles that were always turning up. Many of the old rules had to be altered or modified to suit the new conditions. Far, however, from being obstructive, much less prohibitive, the new rules were intended to facilitate business. Members were urged by the committee to close up their accounts as far as possible. Those who had stocks to deliver were advised either to deliver or to close them.

Those who had stocks to receive were asked to take them up and pay for them as soon as they could. There was no suggestion of stopping business and arbitrage operations were in fact increasingly active.

All went fairly well for the first three months. Between the beginning of August and the end of October considerable progress was made with the closing of pre-war accounts. A general stock taking then made at the request of the committee showed that the outstanding liabilities of the House amounted to about eighty or ninety millions sterling. A scheme was now evolved for avoiding forced liquidations during the war and the Treasury appeared for the first time on the scene. It joined the clearing house committee of the banks and the stock exchange committee in a tripartite agreement "with a view to avoiding forced realization on a large scale of securities held as cover for account to account loans."

The clearing banks had previously agreed in consideration of the currency facilities given them by the government to continue their stock exchange loans until the end of the war and for twelve months thereafter at a fixed rate of five per cent. To enable other banks and lenders of money to continue their loans for a corresponding period it was arranged with the Bank of England to advance to them 60 per cent of the value of the securities held by them "against any loans which they had outstanding on the 29 July, 1914, such securities to be valued for the purpose of the advance at the making up prices of the 29 July, settlement." The Bank of England was to have the right when any security reached its end of July price to call on the borrowers for a repayment to the extent of its value. Failing compliance it was to have a right of sale at not less than the settlement price.

These were all the concessions that the Treasury made to the stock exchange and such as they were it was much more for the sake of the banks than of the stock exchange they were granted. Moreover, a very substantial *quid pro quo* was exacted for this nominal service. Excuses have been offered for the Treasury that it was still confronted by many novel and puzzling financial problems arising out of the war, and was justifiably cautious in consequence. The banking problems it met fairly and up to a certain point successfully, thanks to the sound advice it received from the principal banking authorities who had loyally placed themselves at its serv-

ice. Unfortunately no opportunity was given for an equally good understanding between it and the stock exchange.

### The Politicians and the Stock Exchange

The professional politicians have always been shy of Capel Court. Many of them look askance at it for moral reasons and many more pretend to share these scruples. The average member of the House of Commons speaks respectfully of Threadneedle Street and Lombard Street, but he is given to sneering at the stock market. He may think that by treating it as a "glorified gambling shop" he commends himself to his more strait-laced constituents. Or, possibly like the ministerial victims of the Isaac Marconi scandal he may not have been very lucky in his speculations. Whatever the reason, there has long been an undercurrent of parliamentary suspicion and prejudice against stock exchange men. The year before the war broke out this had been intensified by the action of the stock exchange committee in frustrating the attempt of the House of Commons to whitewash the ministers implicated in the American Marconi gamble. After the collapse of the whitewashing committee and the adoption of a condoning resolution by the friends of the government the stock exchange had instituted an independent inquiry into the flotation of the American shares. The result was a severe condemnation of the transaction and various terms of suspension for the members implicated. Then the public had the remarkable paradox presented to them of a higher standard of morality being recognized by stock jobbers than by our law makers. But the ministers and their henchmen had not long to wait for their revenge. The war and the financial crisis into which it plunged the city placed every trader and financier in the country at the mercy of the government. With none too delicate taste Mr. Lloyd George and Lord Reading assumed control of the stock exchange. They practically superseded the committee which, however, was no great misfortune as very few of its members were men equal to the emergency.

Moreover, the few strong men among them were under heavy obligations to the banks which completely tied their hands. They could offer no effective opposition to the edicts of the Treasury endorsed as these invariably were by the banks. When at last the stock exchange was permitted to reopen on the fourth of January,

1915, the permission was to a large extent a mockery. All that it really gained was shelter from the weather under its own roof and at its own expense. What it had to give up was not merely its liberty but the best part of its business. Arbitrage operations were absolutely stopped—an interdict which cut off at a stroke three of its best foreign markets—American, French and Dutch. It was forbidden to do any business after three o'clock, the precise hour at which New York cables begin to come in. It could not deliver any bonds or bearer shares which had not been in the physical possession of the vendor in the United Kingdom since a certain date in the preceding September (1914). It could not transfer any registered shares which did not comply with a similar condition. It could not take part in the issue of any new shares or in the raising of fresh capital for an existing company without the express sanction of a special committee of the Treasury appointed to act the part of watch dog. It could not deal either privately or publicly in any new issue without the authority of the Treasury conveyed through the stock exchange committee. It could not enter into any time bargains and all dealings had to be for cash.

### The Imposition of Minimum Prices

As if that catalogue of "don'ts" were not long enough to reassure the parliamentary lawyers against all the financial perils they could conjure up, minimum prices were affixed to the greater part of the official list. The "making up" prices of July 27, 1914, were adopted as a sort of legal bed rock below which stocks were not to be allowed to fall. This edict was not strongly objected to at the time nor in fact was there much open opposition of any kind. The official description of them as "Temporary Regulations for the Reopening of the Stock Exchange" disarmed criticism at the outset. But if members had had the slightest suspicion how long the minimum prices were to be retained they might have been much less submissive. No important relaxation of them took place until after the successful floating of the McKenna loan in June, 1915. This enabled the joint stock banks to unload their heavy lines of consols by the indirect process of converting them into "McKennas." Then they were allowed to flop about ten points and pass into cold storage.

The next set of minima to be released was colonial government

stocks. The joint stock banks had never been very large holders of these, so they did not risk much in having the peg taken out. They were chiefly held in the House by dealers in the consol and colonial markets and before the war the public absorption of them had been so persistent that very little floating stock remained. There was thus little risk in letting them stand on their own feet. The group of securities which suffered most under the minimum régime was the preference and debenture stocks of the home railways. For some inscrutable official reason these were hung up for nearly a year and a half. After many false alarms the pegs were taken out on the fifteenth of May, 1916, and a slump of ten to twenty-three points at once took place: surely a rare experience for gilt edged securities without a trace of wild cat about them. Before the war they had been our most favored trustee investments—more favored even than consols. They were held to be quite as safe as consols and they yielded a somewhat larger return which commended them strongly to middle class trustees. The small investor was also partial to them and so were provident societies including even trade unions.

Why this particular market should have been shut down for nearly eighteen months defies explanation. None in fact was ever attempted. From the first the stock exchange committee disclaimed any responsibility for the closure though they could give no information as to the responsible authors. All they could say was that the order came from the Treasury and in the public interest had to be obeyed. Whether the order was issued by a Treasury clerk or by the Chancellor of the Exchequer could not be ascertained. After much importunity a reluctant reception was given to a deputation of private members who desired information on various knotty points. When the deputation arrived it found the Chancellor of the Exchequer entrenched in a small crowd of bankers and financial authorities including Mr. Lloyd George's *fidus Achates*, Lord Reading. Polite sympathy was all they got. Not a single shackle was removed until long after.

### Obstinacy of the Treasury and the Results

Even when the Treasury found that the boycotting of home railway prior charge stocks was recoiling on itself it would not yield. Like Pharaoh, it hardened its heart and would not let the

Israelites go. Deceased estates came tumbling into Somerset House (the headquarters of the Inland Revenue Department) nearly every one of them containing minimum priced securities for which there was no market. No jobber would buy them at the official minimum which was the pre-war price calculated on a yield of say four per cent. As the war had knocked down all corresponding stocks to a five per cent level it was naturally concluded that home railway prior charges should follow suit. By keeping them pegged up at impossible prices, the Treasury was unable to have the necessary valuations made for its death duties. In the course of a few months millions of securities accumulated with which it could not deal.

Duties ranging up to 20 per cent of the gross value of a deceased estate could not without rank injustice be levied on arbitrary valuations ten or fifteen points above market level. On the other hand, the liquidation of these estates could not be blocked indefinitely. At last the Treasury offered what it doubtless considered a generous alternative, namely a discount of 7½ per cent from the official minimum. It thereby created a Gilbertian situation. Stocks could be dealt in privately with the Treasury but not publicly in the stock exchange. Then there were two minimum prices—the stock exchange minimum which was ten or twelve points above the market and the Treasury minimum which was only four or five points above the market. Nor was this an insignificant case of a few exceptional stocks. Hundreds of separate securities and two or three hundred millions of money were involved in it.

During the boycott the writer was informed by one dealer that out of a hundred and fifty stocks on his book he could deal only in half a dozen. Holders of the other 144 stocks were absolutely tied up with them for eighteen months, and not a word of explanation could be got anywhere or a hint as to how long the senseless boycott was going to be maintained. In the end it was taken off quite suddenly and at a few days' notice. Then another Gilbertian result happened. After the first slump had landed prices at bed rock a recovery at once set in and within a few days average gains of three or four points were recorded. If the Treasury had apprehended a rush of sellers it must have been agreeably disappointed for buyers were chiefly in evidence. The dealers had very little stock on their books—a surprise which also occurred in other mar-

kets, colonial stocks especially. These boycotted markets had in fact been nearly sold out before the boycott was put on.

Then the Treasury had another surprise. The Chancellor of the Exchequer had talked early and often about our patriotic duty to conserve our financial resources for carrying on the war. Apparently he thought that by bottling up existing investments he would be laying up money for future war loans. But his policy worked the other way. While the regular investment markets were bottled up his principal war loan—the McKenna loan of 1915—declined from par to under 95 or fully five points. As soon as his boycott was removed both the war loans and gilt edged securities generally lifted their heads again and the stock exchange had the best week in its experience since it was reopened. The credit of this welcome revival must be shared, however, with Wall Street. It gave Capel Court a vigorous lead and Capel Court played up to it. For the first time in the war London and New York were both comparatively buoyant.

Thus we have double proof that the Treasury boycott was a bad blunder. While it was in force, the stock exchange languished and was dying by inches. The moment it was removed a sharp rally took place and healthy markets appeared where there had been universal stagnation and despondency. The success of the home railway release was so marked as to impress even the Treasury pessimists. They were emboldened by it to unlock the last of the remaining shackles—those on local loan stocks, Indias, and municipals (classed in London as "Corporation Stocks"). If anything could have been more puzzling than the boycott itself it would have been the extension of it to India.

### The Boycott and the Indian Market

The Indian market was the last that should have been boycotted for much depended upon it. Political order and security had to be preserved by every possible means. Our financial as well as our military prestige had to be maintained. The utmost use had to be made of the capacious market which India offered for our exports. As a safeguard against exchange troubles securities and credit paper of every available kind should have been kept in active circulation. A living stream and not a dead pool was what the emergency required. But the lawyer financiers at the Treasury could not grasp

that fundamental principle of business. They could not trust business men to take care of themselves and to do their duty by the country. So they wove round them a network of prohibitions and restrictions which hampered them at every turn. An untold amount of help which might have been obtained from India was thus deliberately sacrificed. The greatest of our oversea dominions, instead of being drawn closer to us by the war as all our other dominions and colonies were, was rather held at arm's length. The minimizing of India stocks was not the least of the Treasury's mistakes.

### The American Market

There were a few markets which fortunately for themselves the Treasury could not "minimize" or doubtless it would have been done. The largest and most important of these was the American market. It would have been useless for the Treasury to attempt to control prices which nowadays are made in New York rather than in London. The only possible effect of such a policy would have been to drive American business out of the House and into the hands of foreign firms over whom the Treasury could have little or no control. At all events it did not attempt to exercise any, and often orders which could not be executed in the official market were quite practicable in some Jewish resort across the street. The Treasury veto on arbitrage transactions, its three o'clock closing edict and the disqualification of all shares which had not been in physical possession in the United Kingdom since September, 1914, were sufficiently hard on holders of American securities without subjecting them to the further hardship of minimum prices.

The beneficial effects of this comparative freedom were speedily apparent. From the day that the New York stock exchange reopened prices took an upward turn. This enabled British holders of American stocks to liquidate gradually. During the prolonged demoralization which preceded the war, prices had got down to bed rock and the upward turn in accordance with its usual rule followed very sharply. Between August, 1914, and the special settlement in the following November a very considerable rally took place—thanks almost entirely to Wall Street. But for it the great reduction in the stock exchange account which occurred during these four months would have been impossible. Had there been minimum prices

fixed on all American stocks London would have been shutting itself out from that opportune boom. The reopening of the London stock exchange in January, 1915, was made the occasion of another bull performance. The "munitions boom" as it was called, became fast and furious, but London had very small interest in it. One or two Canadian companies which had obtained large contracts happened to have a small market here which flared up for a few weeks and then died down. However, even these few crumbs from the trans-Atlantic table put fresh heart in the half-ruined Capel Court

## THE MUNITIONS BOOM

The next notable episode in the American market was a very curious one. The "munitions boom" in New York grew out of our own shrapnel scare in May, 1915, which precipitated the formation of the Coalition Cabinet, the creation of a Munitions Department and the huge shell contracts showered on American manufacturers in the succeeding months. These special additions to our already huge imports from the United States and Canada upset sterling exchange so completely that even Downing Street optimism was no longer proof against it. The ordinary remedies—gold shipments and a few turns of the bank rate screw—would have given only momentary relief. The crisis demanded more heroic and durable remedies. The banking experts could suggest only two—the first, a large loan in New York, and the second a wholesale return of our American dollar securities to their native country. This was another chance for the Treasury. It began by employing dealers and brokers in the American market to buy up all they could get of the bonds that could be most easily gathered in. This went on for several weeks, bull prices being paid for every obtainable bond. A direct appeal was next made by the Treasury to the public to sell their American bonds which many of them did. But such a Moloch was the sterling exchange at twenty points under parity that a second appeal had to be made to public patriotism for bonds on loan. All very unique incidents indeed, in war finance.

London differs from most other financial centers in possessing a great variety of markets. The continental bourses depend on a few large groups of securities—government stocks, railways, mines and metallurgical works. Their industrials are generally on a larger scale than ours, but more limited in number. American

industrials are both numerous and gigantic but even they lack some of the peculiar features of the British stock market. For example, they have no tea and rubber group. They have few if any colonial groups. They have no exploration companies like the British South Africa (alias "Chartered"), the Tanganyika, the British Borneo, etc. They have not as yet—though apparently they hope to have soon—international corporations destined to extend American trade and finance to the remotest corners of the globe. London was rich in these oversea reserves, second strings to her bow as it were, and they did good service when the war strain was greatest.

In the first year of the Treasury régime, when all the investment markets were "minimized," the stock exchange lived mainly on rubber and oil shares. Both commodities were in demand for war service, and well managed companies were able to show handsome profits. A rubber and oil boom gradually developed and a comparatively small volume of operations produced important psychological results. They showed that there was still some bottom left in at least two of our markets. The fact that free dealing survived in one or two corners of the House had also an encouraging influence. Even the Treasury had to recognize the necessity of giving a free hand to rubbers, oils, Kaffirs and shares of that class. Any attempt to throttle them in Capel Court would only have forced them to find a new outlet elsewhere. Tea shares might have migrated wholesale to Mincing Lane while Johannesburg and Cape Town would have snapped up the Kaffir Circus.

### SECRECY IN BRITISH FINANCE

The bondage which the stock exchange for nearly two years had to endure at the hands of the Treasury and its promiscuous experts may seem incredible to American readers unfamiliar with the traditions of British politics and finance. These have no counterparts in New York and some of them are the exact opposites of American ideas on the same subjects. Publicity is the keynote of American finance. Secrecy is the British keynote. In the House of Commons, in public departments, in the banks, in the stock exchange and throughout the city the historical motto is "Mind your own business and keep it as much as you possibly can to yourself." Anyone who takes the trouble to glance at the questions put to ministers in Parliament and the evasive answers which ministers give to them

will very correctly conclude that mystification is a parliamentary fine art. It is almost equally cultivated in the city.

What would be thought of the oldest bank in the United States if it had never in all its long life made a detailed report to its shareholders or submitted to them a working balance sheet? But that is literally true of the Bank of England. It is the one great international bank which never takes down its shutters. Every half year the shareholders assemble in the board room to hear the amount of the "rest" or divisible balance and to be told what dividend they are going to get. Beyond that all is twilight and secrecy. Shareholders in the joint stock banks are rather better treated but not much. They get a few details of their position, the meagreness of which is atoned for by an oracular address from the chairman reviewing the financial condition of the world at large. This high example is followed more or less closely by all joint stock chairmen. To make shareholders believe that they are getting valuable information when they are only having their ears tickled with platitudes is one of the most useful secrets of British joint stock directors.

When officials and business men take to playing the secrecy game on each other the officials generally come off best. That is what happened in the city with most of the special war measures that had to be adopted. Quietly, stealthily and sometimes even craftily the Treasury and the board of trade gathered up the strings of nearly all kinds of business and pulled them this way or that as the necessities of the crisis demanded. They appointed advisory committees, expert committees, special committees and sham committees. They dissolved them, reorganized them, renamed them, and turned them over from one job to another indiscriminately. They set lawyers to investigate the management of the aircraft service and at the most critical stage of the war the Chancellor of the Exchequer deserted the Treasury in order to organize a new Munitions Department.

## Political Dictation to Business

Had Lord Reading and Mr. Lloyd George really been the heaven born financiers their friends considered them to be, the last thing they would have dreamed of would be to control the city from a dark room in Downing Street. Such, however, was the régime under which the city had to languish for months. While all

branches of commerce were "regulated" the stock exchange was practically strangled. Today it is simply a shadow of its former self. The American market has suffered so seriously that its recovery will be a question of years. The older and more despondent members begin to doubt if it will ever recover at all. Many of them have retired from business and others have migrated to less damaged markets. There have been not a few deaths among the "fathers of the House" accelerated, perhaps, by the "temporary regulations."

Altogether the contrast between Capel Court and Wall Street on this occasion is sad and by no means flattering to British self esteem. It may be objected that no fair comparison can be drawn between a stock market saddled with a great war and one which is enjoying all the advantages of a neutral. But no one would for a moment have expected Capel Court to right itself after the first shock of the war as quickly and easily as Wall Street did. Making, however, all reasonable allowance for its much heavier task the fact remains that it floundered and blundered much more than it need have done had its management been in wiser hands. No one connected with it now doubts that it would have got over the crisis much more quickly and with less damage had it been more left to itself. An entirely free hand it could not and did not expect, but the Treasury yoke was unnecessarily heavy and galling.

## BETTER METHODS ADOPTED IN WALL STREET

In a former work, the writer has paid an admiring tribute to the skill and success with which the war crisis was handled at the outset by the committee of the New York stock exchange. In describing the sensible methods they adopted he said:

> A Committee of five was appointed with absolute power not only to make emergency rules but to see them carried out. They started with a complete suspension of business and then granted partial resumptions as the market recovered and could be trusted with a freer hand. In this way the embargo was gradually removed and within six months Wall Street was again on a normal footing.[1]
>
> One reason for the greater smoothness and speed with which the restoration of Wall Street was effected has been already given—namely, its simpler and more up to date machinery of settlement. Another and more important one has now to

[1] *British War Finance*, p. 131.

be added. It was the different spirit in which the two operations were conducted. Wall Street was allowed to reorganize itself. Its Committee of Five had only the stock market to consider and their one duty was to set it as speedily as possible on its feet again. They had not to guard it against war risks or enemy aliens or other political dangers. All its operations and arrangements had to be regarded primarily from the stock market point of view and not as in London from the point of view of the Treasury and the banks.[3]

Eighteen eventful months have passed since these words were written but time has not diminished in the slightest degree their force and significance. On the contrary, it has greatly intensified the contrast drawn between the British and American stock markets. Americans themselves appear to have a very vague and inadequate appreciation of the superior freedom and independence which their investors enjoy. Even broad-minded and widely informed authorities like Mr. Otto Kahn have fallen into strange misconceptions as to the relative positions of politicians and business men in the old and the new worlds. In an address which he delivered in April, 1916, to the American Newspaper Publishers Association, he said:

Everywhere else throughout the civilized world in matters of national policies as they affect business the representatives of business are consulted and listened to with respect, which is due to expert knowledge. It is only in America that the exigencies of politics not infrequently—I might almost say habitually—are given precedence over the exigencies of business. When scolded, browbeaten, maligned, and harassed, finance may well turn upon its professional fault-finders, and challenge comparison.

That flattering picture of the business expert who is consulted and listened to with respect may be in a limited sense true of Mr. Kahn's native country, Germany, but in few other parts of Europe would it be recognizable, least of all on British soil. Nowhere is the professional politician so overbearing and the business man so overborne as in the British House of Commons. This unnatural and unhealthy condition had its origin twenty years ago in the advent of labor democracy. Before the war it was rapidly becoming intolerable. Labor and capital were steadily drifting toward a life and death struggle. The war found a lawyer cabinet in control not only ignorant of business but jealous of business men and much less ready to work with them than to work against them.

A generation ago Mr. Kahn might have found in London some

[3] *British War Finance*, p. 133.

traces of his ideal world in which representatives of business were listened to with respect even by popular politicians but these days had long departed before the war. The relations between politics and business had undergone an almost revolutionary change. The investor had been even more unfortunate than the man of business for his center of gravity had been changed not merely once but two or three times. The value of money had shifted backwards and forwards. Investment values had followed the upward and downward movements of money. In addition to their own proper risks investors had had to suffer all the chances and changes of political finance. A rapid succession of Chancellors of the Exchequer with different ideas and policies became a chronic danger to them. They began to realize that the Treasury and the House of Commons were their natural enemies.

## Conclusions

The reader must draw his own conclusions from the foregoing description of the Treasury régime in Capel Court. With modifications a similar picture might be drawn of the great grain market at the Baltic, of the Metal Exchange, Mincing Lane, Lloyd's and other national marts in the city. One and all of them were—not "democratized" as electioneering dupes had been led to expect, but "bureaucratized"—quite a different thing. The defence of the Realm Act and its many amendments gathered the whole of them into an official net which was drawn closer and closer as the war proceeded. Mr. Otto Kahn was therefore under a strange delusion when he professed to envy British men of business for the homage paid to them by the politicians. The two classes have been at daggers drawn all through the war. So far the politicians have had the upper hand and they have not hesitated to use it.

This will be one of the main issues of the next general election which the Coalitionists will put off till the end of the war if they possibly can. But the House of Commons is confessedly moribund and its unpopularity may become so strong as to render any further extension of its life impossible. Whether the inevitable appeal to the people comes soon or late, it will be a crucial event for all the complex interests of the city and especially for the stock exchange. The future of British investments is wrapped up in a huge combination of political, industrial and fiscal problems.

Before stock values or indeed any kind of values can regain their normal level the struggle of the politician and the business man for mastery will have to be decided once for all. Before industrial harmony can be reëstablished capital and labor will both have to give up their class selfishness and consider what is best for the community.

Until some of these bed rock problems are settled the British investor will have a very precarious and uncertain outlook. The restoration of British supremacy will demand gigantic efforts on the part of its rulers, its financiers, its industrialists and its traders. Whether people who have hitherto worked chiefly for their own hands and who know very little about the higher forms of coördination and coöperation can be induced to close their ranks at a moment's notice is none too sure. It is certain, however, that nothing less will rehabilitate the badly battered and now heavily mortgaged British Empire. A tremendous increase of earning power combined with drastic economy both public and private can alone repair the financial havoc which the war is leaving behind it. That calls for loyal and reasonable labor as well as for freedom of capital and a minimum of political dictation.

# THE AMERICAN SECURITY MARKET DURING THE WAR[1]

By S. S. Huebner,

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Business in the United States is admittedly on a war basis today, and the security market is simply reflecting that abnormal condition. Preceding historic booms in the stock market have usually had as their principal cause some one central idea. An overworked public imagination, obsessed with some widely advertised idea, has usually been responsible for a rise in price levels far beyond the limits of reason. In 1899 the public mind was inflamed by the prospect of large gains from industrial combinations at greatly inflated prices for the constituent companies. In 1901 the possibilities of railway mergers proved to be the moving spirit. In 1906 it was the prospect of greatly increased dividends. In 1909 the alluring bait was "melon cutting" and the distribution of accumulated assets. At present it seems to be belief in the prosecution of the world's greatest war for some time to come, with the prospect of continued fabulous war profits.

## War Orders the Basis of Our Prosperity

That the war has immensely increased American business along certain lines, especially in those industries that produce the raw materials or finished products that go to fill the war orders of the Allies, cannot be disputed. Pig iron production in the United States during the last twelve months has increased nearly 58 per cent as compared with the preceding twelve months. For August, 1916, production took place at the rate of 3,204,000 tons as compared with only 1,995,000 tons during August, 1914; while the price of No. 2 Southern at Cincinnati has increased from $13.25 to $17.90 in January and $16.90 in August, 1916. The unfilled tonnage of the United States Steel Corporation averaged 9,310,561 tons for the

[1] In the preparation of this article the author is indebted for many of the statistics presented to the monthly compilations prepared from authentic sources by R. W. Babson, and issued periodically in *Babson's Desk Sheet of Tables on Barometric Figures for Business Conditions.*

first eight months of this year, or nearly twice the corresponding averages for 1915 and 1914. Unfortunately, no reliable figures on copper production are available for this year, but press reports indicate large shipments to the Allies and huge orders for future delivery, and the price of the metal has advanced from a monthly average of 12.31 cents (August, 1914) to 28 cents (September, 1916). Probably no less than half of this country's metal output, it has been estimated, is now going for war purposes. Automobile sales during the first six months of the year, we are told, were smaller than the entire 1915 output by only 15 per cent. The shipbuilding industry is also enjoying an unprecedented prosperity, attributable chiefly to war conditions, and the number of steel merchant vessels under construction in American yards is reported to be five times as great as a year ago.

Foreign trade returns also show the large part played by war orders in our present prosperity. Exports of merchandise during the first seven months of this year amounted to the unprecedented total of $2,926,280,815, and exceeded the imports by $1,468,561,241. Again, for the year 1915 exports amounted to $3,546,000,000, an increase over 1914 of $1,433,000,000 and an excess over 1915 imports of $1,768,000,000. Although our foreign trade balance of $961,000,000 for the first seven months of 1915 was the subject of endless comment, being considerably more than twice that for the corresponding period of any previous year, it is noteworthy that the balance for the first seven months of 1916 is even larger by nearly $500,000,000. Yet, the impetus towards even greater exports seems to be gaining strength. In fact, the balance of trade of $262,838,972 during July of this year (the latest month for which full data are available) are more than twice that of July, 1915, when the balance was $125,223,965.

A further analysis of our foreign trade returns shows two important features, both emphasizing the importance of war conditions. The first relates to the great increase in exports to Great Britain, France and Russia. On the one hand Great Britain alone, between January 1 and the present, has contributed nearly one-half our balance of trade. In strong contrast to this situation stands the fact that, excluding blockaded Germany, Austria and Belgium, no less than seventeen out of twenty-one important countries have sent larger imports to the United States during the first half of

this year than they did during the corresponding period of last year. The second feature to bear in mind is the greatly increased importance which certain articles play in our export trade. A recent tabulation[2] (issued last August) shows that exports of fourteen groups of articles, during the past ten months, amounted to nearly $1,798,000,000, as contrasted with only $498,000,000 for the ten months preceding the war. The comparison shows that exports of six of these groups—mules and horses, brass, bronze, etc., automobiles and parts, chemicals, zinc, etc., and explosives—comprised a total of nearly $810,000,000 for the past ten months against $57,000,000 for ten months preceding the beginning of hostilities, an increase of nearly fifteen-fold.

## The Response of the Stock Market

The foregoing figures are given to show the important relation between war orders and our present prosperity. Since the essential function of organized exchange markets, aside from furnishing a convenient market place, is to discount future business conditions, it is only natural that with the re-opening of the markets in December, 1914, there should have developed almost immediately a violent upward price movement in stocks, representing munition, iron and steel, metal, shipping, motor, textile, and other industries which shared direcly or indirectly in huge profits derived from exceedingly

[2] Babson's Report of August 29, 1915, shows the following:

| Exports | Past ten months | Ten months before war |
|---|---|---|
| Mules and Horses | $73,000,000 | $3,500,000 |
| Brass, Bronze, etc. | 155,000,000 | 6,000,000 |
| Automobiles and Parts | 116,000,000 | 20,000,000 |
| Railway Cars | 21,000,000 | 10,000,000 |
| Aeroplanes | 6,300,000 | 195,000 |
| Chemicals | 93,000,000 | 22,000,000 |
| Motorcycles | 2,700,000 | 900,000 |
| Cotton Goods | 88,000,000 | 43,000,000 |
| Iron and Steel | 472,000,000 | 212,000,000 |
| Shoes and Leather | 120,000,000 | 47,000,000 |
| Canned Goods, Meat and Dairy Products | 231,000,000 | 124,000,000 |
| Wool and Woolen Goods | 47,500,000 | 3,900,000 |
| Zinc, etc. | 36,800,000 | 328,000 |
| Explosives | 336,000,000 | 5,000,000 |
| Total | $1,798,300,000 | $497,823,000 |

large orders for war materials at extraordinarily high prices. In fact the stock market of the past two years has been largely one of "specialties." As regards shares of corporations of the non-war-serving type, the rise in prices, although influenced somewhat by increased traffic or business growing out of the war, has been moderate and not excessive. But as regards the so-called "war stocks," the stock market witnessed a speculative craze, probably without a parallel in history. Alluring possibilities of fabulous war profits were the central idea. All other factors that usually play a prominent part, such as unsettled labor conditions, rapidly rising commodity prices, a crop failure in the Northwest together with heavy losses in corn and cotton, and the destructive effects of the great War itself, seem to have been forgotten.

Not only did the shares of many "specialties" increase several hundred per cent in price within a year, a phenomenon to be discussed more fully later, but the volume of sales also reached record-breaking proportions. During 1915 shares traded on the New York exchange totaled 173,070,962 as compared with 47,899,668 and 83,470,693 in 1914[3] and 1913. This year's transactions are even greater, total sales for the first eight months amounting to nearly 109,000,000 shares as contrasted with less than 97,000,000 for the corresponding months of 1915. At the time of writing (September 23) the New York market has just had its fifteenth consecutive day, excluding the two-hour Saturday sessions, in which the trading far exceeded a million shares, and approximately averaged a million and a half total. It is also worthy of note, as indicating the direction of speculative activity, that many stocks which formerly played only a relatively minor part in the volume of transactions on the New York exchange have suddenly become very prominent. One may point to a recent instance, for example, where for an entire week the sales of eleven war stocks—American Smelting, Anaconda, Baldwin Locomotive, Central Leather, Crucible Steel, Inspiration Copper, International Mercantile Marine common, International Mercantile Marine preferred, International Nickel, Kennecott Copper, and Maxwell Motors—represented over one-third of the total sales on the New York exchange.

[3] Note should be made of the fact that the stock exchange was closed for nearly four months during 1914.

### Influence of Low Money Rates

Another phenomenon of the present market is the prevailing low rate for money. It is an axiom of the street that low money rates encourage higher stock prices and, vice versa, that great activity in the stock market at inflated prices causes money stringency and higher interest rates. Today, however, after nearly two years of stock market boom, we have the spectacle of brokerage houses getting all the credit they want at $2\frac{3}{4}$ per cent, while prime commercial paper can be discounted at $3\frac{3}{4}$ per cent. Crop-moving demands, record-breaking business at high prices and several weeks of million-share days on the exchange seem to have not the slightest effect on money rates. There can be no doubt that present abundance of credit is largely responsible for maintaining stocks so long at unusually high prices.

Such an unusual situation is chiefly the result of two principal factors, *viz.*, England's policy of sending gold to this country and the new Federal Reserve Act. England's wishes are manifestly to liquidate at highest prices such American securities as she may hold and wish to sell, and to effect loans in the United States at the lowest possible rates of interest. With easy money rates and firm stock market prices large loans can certainly be distributed to better advantage. England has also entered upon a policy of mobilizing American securities with a view to using them in this country as pledges for loans. Her advantage in carrying out this policy certainly lies in keeping the price of her collateral as high as possible. Moreover, high prices are also advantageous to England and her Allies for the actual sale of American holdings of securities. In fact, such sales since the beginning of the war have been an important factor in keeping down the price of many leading American issues.

Yet in all probability the sales would have been effected at lower and declining prices had it not been for the strong upward movement in other quarters of the market. In other words, securities act more or less in sympathy with one another and rising prices in one quarter of the market often enable free liquidation at steady prices in another. From every point of view, therefore, it is clear that England is vitally interested in the maintenance of relatively low interest rates in New York, as well as a high and firm security market. To accomplish these purposes she has found it

advantageous to pay for a great share of her purchases here with gold. As a means to the end just indicated, over $700,000,000 of gold has come to the United States since the beginning of hostilities. In addition to this factor mention should be made of the Federal Reserve Act as a cause of inflation. Again and again we see it stated that warnings concerning the present market should not be taken too seriously. The new banking law, providing much greater credit facilities than the law it supplanted, will take care of the situation—so go ahead! It would be well to bear in mind that the present surplus reserve of the New York Clearing House banks, so frequently characterized in the newspapers as "very comfortable," would not exist today under the old reserve requirements; instead there would be a large deficit.

### RISE IN THE PRICE LEVEL OF INDUSTRIALS

Nothing has happened in the security market since the beginning of the war which in any way compares with the speculation in industrial stocks, and particularly those benefiting directly or indirectly from war orders. In discussing market movements since the beginning of hostilities a clear distinction must be made between industrial stocks and the rest of the market. The latter has thus far enjoyed only a modest appreciation; the former present the picture of fabulous war profits and an unprecedented appetite for stocks at enormously increased prices. The situation is all the more noteworthy in view of the fact that it has occurred in the face of the heaviest foreign liquidation to which the American market has ever been subjected. During 1915 the amount of United States Steel common owned in Europe is reported to have decreased 41.6 per cent. Yet, during that year, the price of the stock rose from 48 to $89\frac{1}{2}$, and since that time reached $120\frac{5}{8}$. Every reader is familiar with the flight of Bethelem Steel from $33\frac{3}{4}$ on July 30, 1914, to 600, and of General Motors from 78 to 750. In fact, nearly every week has had its sensation in the industrial list and many issues might be mentioned which increased from 200 to 400 per cent in the short space of a year.

The use of averages, however, will present a fairer picture of the situation. Thus, taking forty-seven leading industrials[4] listed on the New York Exchange, representative of all important types of ac-

[4] See Appendix.

tivity, it appears that on July 30, 1914 (closing prices) one share in each of these corporations could have been purchased at an aggregate cost of $2,786. Using the highest price attained during 1915, these same shares would have brought a total of $6,045, thus showing an appreciation of 117 per cent within about a year. By September 8, 1916, however, the total price had dropped to $5,202, an appreciation of 87 per cent over the price of July 30, 1914.

Selecting next a list of twenty-seven leading industrials,[5] which have figured largely in the newspaper accounts of war orders, the appreciation has been even greater. On July 30, 1914, one share in each of these corporations could have been purchased at a total cost of $1,178. At the highest prices of 1915 these same shares represented an aggregate price of $3,882, an appreciation of 229 per cent. By September 8, 1916, the price had declined to $3,111, an appreciation of 164 per cent as compared with the price of July 30, 1914.

Even greater has been the rise in the price level of leading "ordnance stocks." Unfortunately, averages cannot well be obtained here, partly because few of these stocks were quoted on July 30, 1914, and partly because quotations have been so frequently changed by increasing the stock or by shifting old securities into new. The combined price of nine of these stocks, however (comparing the quotations for July 30, 1914, with those of December 31, 1915), shows an appreciation of 311 per cent. Copper stocks, likewise, owing to large war orders and an increase in the price of the metal at New York within the past year from 17.75 cents to 28.38 cents, have shown large advances. Babson's average price for twenty active copper stocks stood at 54.1 for September of this year as compared with 31.9 for December, 1914.

## PROMOTION OF NEW ENTERPRISES

Intense activity on the stock exchanges, accompanied by rapidly rising prices and an abundance of newspaper comment on large profits and the placing of huge orders, almost invariably prepares the public for participation in new ventures and thus furnishes the opportunity the promotor wants to distribute his wares. Probably never before were rumors of immense orders and prophecies of unheard-of profits so persistently paraded before the reading public day after day. It is, therefore, not at all surprising that the

[5] See Appendix.

last four months of 1915 and all of 1916, up to the time of writing, should furnish abundant evidence of the avidity with which the public absorbed new security issues.

New incorporations in the eastern states with an authorized capital of one million dollars or over are reported as aggregating $1,803,000,000 during the first eight months of 1916 as contrasted with only $606,000,000 and $618,000,000 for the corresponding months of 1915 and 1914. For the past twelve months (September, 1915, to August, 1916, inclusive) new incorporations aggregated the extraordinary total of $2,624,000,000, or almost three times the amount reported for the preceding twelve months. New securities issued by existing corporations totaled $1,617,000,000 during the first eight months of 1916 and $2,151,000,000 for the twelve months from September, 1915, to August, 1916, inclusive. These figures are respectively 1.7 and 1.9 times as large as those for the first eight months of 1915 and for the twelve months from September, 1914, to August, 1915. These totals are all the more significant when we reflect that since the opening of hostilities abroad we have loaned over $1,500,000,000 to foreign borrowers, and have reduced our indebtedness abroad by about $1,800,000,000 through the repurchase of American securities held in the belligerent countries.

The flotation of motor, munition, steel, chemical and engineering stocks, particularly along the lines profiting from war orders, constitutes a large part of the totals given. It may be added that an examination of the most active of this type of new stocks issued during the past year shows that most of them reached their highest price level during the period of flotation, and that in the great majority of instances present price levels are much below the quotations prevailing at or shortly after the period of flotation. The aggregate underwriting price of fifteen representative and important stocks (of the type indicated and floated during the past year) was $882. The aggregate "highest price" of these same stocks (attained in ten out of the fifteen instances during the month of flotation) was $1,259, or an increase of 42.5 per cent over the underwriting price. Last August the price was down to $777, a decline of over 38 per cent as compared with the highest price and of nearly 12 per cent as compared with even the underwriting price.

## RAILROAD AND PUBLIC SERVICE STOCKS AND BONDS

As already stated, a discussion of our subject involves a clear distinction between the market movements of "war stocks," or of industrial and mining stocks benefiting indirectly from war orders, and the rest of the market. As a general proposition the balance of the market has not followed the war stocks in their erratic upward movement. This is notably so with respect to the large group of railroad stocks. Despite excellent gross and net earnings during the past year, nearly all the standard railroad stocks have persistently failed to keep company with the rapidly rising price level of industrial issues.

Using twenty-two leading railway stocks as a basis,[6] representing every section of the country, the average price per share was $80\frac{3}{4}$ on July 30, 1914; the highest price during 1915 was $95\frac{1}{8}$; the highest price during 1916 was $96\frac{1}{2}$; while on September 8, 1916, the price stood at only $89\frac{3}{4}$. In other words the highest average price for these representative railroad stocks since the beginning of the war shows an appreciation of only 19.5 per cent over the price level of July 30, 1914, while by September 8, 1916, this appreciation was reduced to only 11.14 per cent. Contrast these percentages with 117 per cent and 87 per cent for our list of industrials (including war stocks) and 229 per cent and 164 per cent for our list of strictly war stocks!

Public service corporation stocks have shown a tendency similar to that exhibited by the railroads. Using ten leading and representative issues, listed on the New York and Philadelphia exchanges, the average price per share was $68\frac{3}{4}$ on July 30, 1914; the highest price during 1915 was $81\frac{3}{8}$; the highest price during 1916 was $83\frac{1}{2}$; while on September 8 of this year the price was $80\frac{1}{4}$. The highest price level, as compared with the price on July 30, 1914, represents an appreciation of only slightly over 23 per cent, while at the time of writing this appreciation has been reduced to 16.73 per cent.

In the case of standard bond issues the price level has also

[6] Atch., Topeka & Santa Fe, Baltimore & Ohio, Canadian Pacific, Chesapeake & Ohio, Chi., Milw. & St. Paul, Chicago & Northwestern, Erie, Great Northern, Illinois Central, Kansas City Southern, Lehigh Valley, Louisville & Nashville, Missouri Pacific, New York Central, N. Y. N. H. & Hartford, Norfolk and Western, Northern Pacific, Pennsylvania, Reading, Southern Pacific, Southern Railway, Union Pacific.

changed but slightly. Babson's average price of ten leading and representative bonds gives 89.5 as the average price for July 30, 1914, and 91.6 as the average price for September, 1916, thus showing an appreciation of less than 2.4 per cent. The September price compares with 91.8 for January, 1916, 89.2 for January, 1915, 92.5 for January, 1914, 96.0 for January, 1913, and 101.8 for January, 1909. The volume of bond sales on the New York exchange, it is true, seems large, amounting to over $700,000,000 for the first eight months of 1916 as contrasted with only 524 millions and 425 millions for the corresponding months of 1915 and 1914. But these figures are apt to be misleading. Owing to the closing of the New York Exchange following July 30, 1914, there were practically no bond sales for four months of that year, and during 1916 trading in foreign bonds constituted over one-third of the total transactions.

### Apathy of Railroad Stocks

That bonds, with their fixed interest rate, should not appreciate materially is logical enough. We need only consider the present temptation to investors and speculators to divert the flow of capital to stock issues which permit of participation in the large profits that are now being made or are expected in the future. The rapidly increasing cost of living, the rising tendency of long-term money rates, the general feeling that interest rates, as a consequence of the war, will be materially higher for years to come, and the flotation of large foreign war issues in this country on a 5½ and 6 per cent basis with the prospects of further issues, also constitute in their combined effect a powerful deterrent to any upward movement in bond issues yielding only a moderate rate of interest and having a number of years to run before maturity. The resale to us of large blocks of American bonds held abroad, and the temptation to many to invest in foreign securities owing to their low price and the favorable rates of exchange, are additional factors that just now weigh heavily upon the price level of existing American bond issues. But that the common stocks of railroads should not have responded better is not so clear and is today a subject of widespread discussion. As the *Commercial and Financial Chronicle* states in its comprehensive review of railroad gross and net earnings for the first half of 1916:[7]

[7] *Commercial and Financial Chronicle*, September 9, p. 887.

The year 1916 will always remain memorable for the magnificent way in which the great transportation systems of the United States were able to enlarge both their gross and their net income. The year stands unique for the imposing nature of the gain in gross and net alike. In this these transportation agencies, of course, simply reflect the wonderful expansion in trade and industry generally as the result of the demands upon the United States arising out of the gigantic conflict, being waged between the leading countries of Europe. Prior to the present expansion in revenues, which had its inception about September or October last year, the railroad industry had for many years been languishing. Indeed, it was in a bad way, as cost of operations was rising and traffic and revenues failed to expand in a commensurate way. But under the stimulus to industry afforded by the present world war, they have now retrieved the past and at one bound regained all they had previously lost, and, advancing to new heights, are now surpassing by far the best records of the past.

Available records clearly show the correctness of the foregoing statement. Instead of an average net surplus of 217,186 cars, as reported by the American Railway Association for the year 1915 (idle cars reached the large total of 327,084 on April 1, 1915), the net surplus for 1914 to September 1, amounts to only 21,145, while on that date there was an actual net shortage of over 14,000 cars. Babson's statement for ten leading railway systems shows gross earnings for the first seven months of 1916 20 per cent larger than for the corresponding months of 1915. For the last twelve months these earnings exceeded those of the preceding year by over 16 per cent. For the same two periods net earnings show an increase of approximately 35 and 26 per cent. The *Commercial and Financial Chronicle's* tabulation for 249,249 miles of road shows that:

As compared with the six months ending June 30, 1915, the gross earnings of United States railroads for the six months of 1916 increased no less than $328,-012,578, the total rising from $1,403,448,334, to $1,731,460,912. As against this large improvement in gross revenues there was an augmentation in expenses in the substantial sum of $161,861,191, but this still left a gain in net in the satisfactory amount of $166,151,387, or 42.26 per cent, the total of the net for the first six months of 1916 being $559,376,894, against $393,225,507 in the first six months of 1915.

## EXPLAINED BY THE UNCERTAINTY OF THE FUTURE

Such an apparently phenomenal showing makes it somewhat difficult to explain the mediocre market advance of our list of representative railway stocks. Manifestly, the significance of present earnings is largely lost when we reflect that the comparison is with very unfavorable returns for 1915 and most of the years immediately

preceding. Heavy foreign liquidation of American railway stocks, no doubt, has also exerted its influence. The stock market is concerned chiefly with the future, and the discounting of an unfavorable railroad situation in the future has probably been more responsible than any other factor for the failure of railway stocks to keep company with industrials in their violent upward market movement. Greatly increased traffic necessarily means increased equipment and enlarged terminals. But rolling stock, other equipment and buildings now cost more than ever before. Moreover, the labor problem has for over a year loomed threateningly over the railroads and is likely soon to be even more serious. Skilled labor has already aggressively pushed its demands and the claims of unskilled labor will probably soon follow. In all probability the market also regards the huge traffic prevailing just now, traceable very largely to the war, as purely temporary. With the return of normal peace conditions it is probably felt that the railroad troubles of recent years will again prevail. It should not be overlooked that the price of what the railroads sell is regulated by law, while the prices of what they must buy—equipment, terminals and labor—have been steadily rising and are not thus regulated.

## AVERAGE PRICE LEVEL OF ALL STOCKS

The foregoing considerations serve to show the importance of distinguishing between war stocks and the balance of the market. We are too apt, owing to lurid newspaper accounts, to regard the unprecedented rise that has occurred in a limited number of stocks as a characteristic feature of the entire market. A greater mistake could not be made. Considering the stock market as a whole, a substantial rise in prices has occurred, but the average rise is not out of proportion to that which has taken place in some former bull markets. Moreover, if we exclude the war "specialties" in which sensational price increases have occurred, the average price level of the balance of listed stocks will show only a moderate advance.

*The Annalist's* table,[8] giving the market value of all listed stocks on the New York Exchange on September 16, 1916, and at the outbreak of the war, shows (1) that "no less than $3,044,226,000 has been added to the market value of the securities (shares)[9] which

[8] *The Annalist*, Sept. 18, 1916, p. 357.

[9] Words inserted by the author.

were listed on the New York exchange at the outbreak of the War," and (2) that "including the accessions (of new shares)[9] to the list the total market value today is $4,199,157,000 above the aggregate market value of listed issues at the outbreak of the war." The value of listed shares on July 30, 1914, is given as $9,225,813,000. The rise of $3,000,000,000 in value thus indicates an increase of 33 per cent. But even this average, it should be noted, includes all the listed war industrial and mining stocks.

The foregoing general average is quite in keeping with the actual improvement of American business as a whole during the past two years. Here again we are too apt to regard the unprecedented business boom enjoyed by certain corporations as prevailing in all industries. This again is an exaggerated view to take. Bank clearings of the country, excluding New York,[10] probably constitute the best barometer of general business conditions. These amounted to $62,750,000,000 during the first eight months of 1916 as contrasted with 47 billions and 49 billions for the same period in 1915 and 1914, thus showing an increase over 1914 of approximately 28 per cent. But bank clearings are naturally affected by rising commodity prices. Hence the foregoing increase of 28 per cent must be viewed with this factor in mind, and Bradstreet's Index Number for commodity prices, it should be noted, has increased from 9.8495 on August 15, 1914, to an average of 11.4414 for August, 1916.

Just as war conditions have shaped the course of the stock market during the past two years, so it is now the consensus of opinion that the same situation will govern it in the immediate future. All manifestly depends upon the duration of the war. War stocks can scarcely be appraised without knowing when the war will end, and this is admittedly everyone's own guess. Many stocks are certainly too high if the war should stop within the next few months. But should the war and present war orders and profits continue for a year or two more, it is argued by many that present prices will be justified. Judging from the present volume of sales

[10] Total bank clearings, including New York City, are affected materially by dealings on the New York exchange. For the first eight months of 1916 total bank clearings of the United States amounted to $158,674,000,000 as against 112 billions and 110 billions for the corresponding months of 1915 and 1914. This would seem to show an unusual increase. But the total for 1916 is accounted for very largely by the heavy transactions on the New York exchange.

and the firmness of prices, Wall Street is evidently proceeding on the theory that peace is still remote and that the belligerent nations will continue the gigantic struggle for another year or two at least.

## APPENDIX

### INDUSTRIALS

| | July 30, 1914 | High 1915 | High since Jan. 1, 1916 | Sept. 8, 1916 |
|---|---|---|---|---|
| Allis-Chalmers | 7¼ | 49½ | 33⅞ | 23¾ |
| American Agricultural Chem. | 50⅛ | 74½ | 72¼ | 79⅝ |
| American Beet Sugar | 21¼ | 72⅞ | 94½ | 91¾ |
| American Can | 22⅞ | 68½ | 65⅜ | 64⅝ |
| American Car & Foundry | 46¼ | 98 | 78 | 63⅞ |
| American Hide & Leather | 3½ | 14¼ | 12 | 9⅞ |
| American Linseed | 8 | 31⅛ | 25⅛ | 22¾ |
| American Locomotive | 23 | 74¾ | 88¾ | 78¼ |
| American Steel Foundry | 27½ | 74½ | 61¼ | 56 |
| American Sugar | 102½ | 119⅞ | 116½ | 109 |
| American Telephone & Teleg. | 116¾ | 130¼ | 131⅛ | 133⅛ |
| American Tobacco | 221 | 252½ | 209¾ | 223⅞ |
| American Woolen | 12 | 56 | 55¼ | 46½ |
| Baldwin Locomotive | 42 | 154½ | 118⅝ | 82½ |
| Bethlehem Steel | 33¾ | 600 | 550 | 492 |
| Central Leather | 31 | 61¼ | 57 | 59¼ |
| Colorado Fuel & Iron | 23½ | 66½ | 53 | 49⅞ |
| Crucible Steel | 14½ | 109⅞ | 99½ | 83⅞ |
| Distillers' Securities | 12½ | 50½ | 54½ | 45½ |
| General Chemical | 171 | 360 | 350 | 310 |
| General Electric | 140¾ | 185½ | 178½ | 171½ |
| General Motors | 78 | 558 | 560 | 580 |
| Goodrich | 23 | 80¼ | 80 | 72⅜ |
| Int. Harvester of N. J. | 100 | 114 | 119¾ | 117 |
| Int. Mer. Marine | 2¼ | 20½ | 29¼ | 49⅝ |
| Lackawanna Steel | 30 | 94¾ | 86 | 80½ |
| National Biscuit | 125 | 132 | 125¼ | 118⅞ |
| New York Air Brake | 60 | 164¾ | 153½ | 138 |
| North American Co. | 70¼ | 81 | 75 | 68 |
| Pittsburgh Coal | 17⅞ | 42½ | 36¾ | 29 |
| Press Steel Car | 38½ | 78¼ | 65⅛ | 55 |
| Pullman Company | 154 | 170¼ | 171¾ | 165 |
| Sears Roebuck & Co. | 180 | 209½ | 188 | 210⅜ |
| Sloss-Sheffield Steel & Iron | 21 | 66⅞ | 63¼ | 51 |
| Studebaker Corp. | 28 | 195 | 167 | 124½ |
| Texas Company | 123 | 237 | 235½ | 199½ |
| United Fruit Company | 136 | 163 | 169½ | 167¾ |

| | | | | |
|---|---|---|---|---|
| United States Rubber Co. | 52¾ | 74¾ | 58⅛ | 58½ |
| United States Industrial Alcohol | 20 | 131¾ | 170½ | 114 |
| United States Cast Iron Pipe & Foundry | 9 | 31¼ | 26½ | 20½ |
| United States Steel | 55½ | 89½ | 89 | 100¾ |
| Virginia-Carolina Chem. | 24⅛ | 52 | 51 | 42⅝ |
| Western Union Telegraph | 56¼ | 90 | 96⅞ | 96½ |
| Westinghouse Electric Mfrs. | 73⅜ | 74⅞ | 71⅝ | 61⅜ |
| Willys-Overland | 85 | N268 | N325 | 46¼ |
| Woolworth | 92½ | 120½ | 139½ | 137¾ |
| Total | 2,786 | 6,045⅜ | 5,859 | 5,202⅜ |

WAR STOCKS

| | July 30, 1914 | High 1915 | High since Jan. 1, 1916 | Sept. 8, 1916 |
|---|---|---|---|---|
| Allis-Chalmers | 7¼ | 49½ | 33⅞ | 23¾ |
| American Can | 22⅞ | 68½ | 65⅜ | 64⅝ |
| American Car & Foundry | 46¼ | 98 | 78 | 63⅞ |
| American Steel Foundry | 27½ | 74½ | 61¼ | 56 |
| American Woolen Co. | 12 | 56 | 55¼ | 46½ |
| American Locomotive | 23 | 74¾ | 88¾ | 78¼ |
| American Zinc Lead & Smelt. | 12¾ | 71½ | 97⅞ | 38 |
| Baldwin Locomotive | 42 | 154½ | 118⅝ | 82½ |
| Bethlehem Steel | 33¾ | 600 | 550 | 492 |
| Crucible Steel | 14½ | 109⅞ | 99½ | 83⅞ |
| Distillers' Securities | 12½ | 50½ | 54⅛ | 45½ |
| Elec. Stor. Battery | 47 | 60 | 66½ | 66½ |
| General Chemical | 171 | 360 | 350 | 310 |
| General Electric | 140¾ | 185½ | 178½ | 171½ |
| General Motors | 78 | 558 | 560 | 580 |
| Int. Mer. Marine | 2¼ | 20½ | 29¼ | 49⅝ |
| Lackawanna Steel | 30 | 94¾ | 86 | 80½ |
| New York Air Brake | 60 | 164¾ | 153½ | 138 |
| National Lead | 41¾ | 70¾ | 73⅞ | 64½ |
| Pressed Steel Car | 38½ | 78¼ | 65⅛ | 55 |
| Studebaker | 28 | 195 | 167 | 124½ |
| Tennessee Copper | 29 | 70 | 66½ | 26⅞ |
| United States Steel | 55½ | 89½ | 89 | 100¾ |
| Virginia-Carolina Chem. Co. | 24⅛ | 52 | 51 | 42⅝ |
| Willys-Overland | 85 | N268 | N325 | 46¼ |
| Westinghouse Elec. & Mfg. Co. | 73⅜ | 74⅞ | 71⅝ | 61⅜ |
| United States Industrial Alcohol | 20 | 131¾ | 170½ | 114 |
| Total | 1,178 | 3,882 | 3,809 | 3,111 |

N = par $100 per share.

# SHORT-TERM INVESTMENTS AS A STABILIZING INFLUENCE IN INTERNATIONAL FINANCE

By Elmer H. Youngman,
Editor, *Bankers Magazine*, New York.

## I. Bills of Exchange

Primarily, the value of holding foreign bills as an element in stabilizing the condition of the international money market rests upon the same principle that applies when a bank goes into the domestic market and buys commercial paper. The principle is this, that should the bank find it necessary suddenly to replenish its reserves and to curtail loans as the readiest means of doing so, this curtailment, if made wholly in the bank's own locality, might not only occasion serious distress but possibly might result in partial failure of its object. Moreover, a bank naturally feels more disposed to exercise leniency toward its local dealers than to those outside, and will therefore consider itself under little or no obligation to renew paper bought in the open market. There is, of course, another and even stronger reason which operates to cause banks, when having surplus funds, to seek an outlet in the general markets of the country, namely, that in so doing the bank may virtually make selection from the best offerings of commercial paper emitted by firms of established credit and offered for sale by brokers of known reputation. These same principles, in substance, are those which render the foreign bill a high grade form of investment. These instruments, when carefully chosen, are of the very choicest quality of commercial paper; their payment at maturity may be demanded, and the bank holding them is, as a rule, under no obligation to renew. In calling for payment, in the ordinary course, the bank occasions no strain on the American market; but, on the contrary, through the operation, which gives command of gold or foreign credit, any existing strain may be relieved.

### *Securities Compared with Bills of Exchange*

These statements are, of course, subject to some qualification, because, so closely are the great international money markets related, that extraordinary demands made by one upon another

may react to the disadvantage of the one making the demand.[1] We have seen how, in providing for the stabilizing of European exchange, the vast volume of American securities returned here has been sent in driblets. Had this not been done, the capacity of America to repurchase its securities from Europe might have been glutted and thus our ability to be of financial assistance in the European crisis would have been greatly lessened. The normal operations of trade and finance do not contemplate that debts be all paid at once (some of them are scarcely ever paid), and in the case of the securities returned from Europe, most of them were not in the form of obligations, payable either on demand or after a short time, but they were stocks which represented merely the shares of foreign investors in our railway or industrial enterprises, or bonds generally not payable for many years. There was, therefore, no legal or moral obligation on the part of America to redeem these stocks or bonds in cash. All that could be rightfully expected was that facilities be provided for their sale in the open market at such prices as they would bring and the holders of the securities were willing to take.

It is here that, on the score of immediate availability, the bill of exchange offers superior advantages.[2] It is a direct obligation

[1] The gradual restriction on lending which follows a rise in the discount rate of the Bank of England is thus referred to by Sonne (*The City*):

"It is rather a slow proceeding and one which practically has an equal result all over the world, as England is not in a position to demand of one individual country immediate repayment of the whole or part of the funds, lent out in this manner, but she must either definitely decline to renew such short loans, or agree to renew them only at a higher rate. . . . It has therefore naturally been doubted whether this more defensive method would achieve its aim, and be sufficiently sharp in a crisis like this, and whether it would not have been desirable to have an additional line of defence, a third, consisting of a big portfolio of short bills drawn on and accepted by foreign banks. By throwing such a portfolio of short bills on one individual country into the market, it would be possible quickly to turn the exchanges of that particular country in our favor, without at the same time considerably altering the position in relation to other trade centres. It was thought that this method—with which French financiers are especially familiar—in addition to the supply of English bills, would be desirable, and might be useful for the purpose of meeting in case of need, as a sort of counter attack, a drain on our gold stock from any particular source."

[2] "It was due to the circumstance that France had placed nearly all her capital in the shape of long loans, that—although she is one of the richest nations of Europe—her financial position was at first rendered very difficult."—*The City*, H. C. Sonne.

for the payment of money, either at sight or after the lapse of a short time—usually thirty, sixty or ninety days. Payment is not dependent upon the state of the market for its sale, as in the case of stocks or bonds, but merely upon the solvency of the drawer or acceptor. In other words, under normal conditions, the payment of the bill in accordance with its tenor may be relied upon absolutely.

### *Bills of Exchange at the Outbreak of the War*

The outbreak of the great European War in the summer of 1914 showed, however, that the bill of exchange, though possessed of the advantages just enumerated, was nevertheless not without its imperfections. In other words, that the most perfect part of the delicate mechanism of international finance succumbed to the shock of war.

Not only did the temporary closing of the stock exchanges in Europe and America at the outset of the war stop for the time being the market for stocks and bonds, but moratoria in most of the leading European countries and in South America as well suddenly congealed the most liquid instrument of international finance—the bill of exchange. No other course was practicable. The credit mechanism, upon whose smooth workings the continued successful utilization of this important financial instrument depends, had broken down. Cover to meet maturing bills could not be provided.[3]

Disarrangement of the mails, closing of frontiers between belligerent countries, and temporary interference with neutral shipping owing to prohibitive rates of marine insurance, all added to the confusion. American tourists, liberally provided with funds of one kind or another, found them unavailable, and the government finally sent over a gold-bearing cruiser to relieve their embarrassment. Extraordinary deposits of gold were made to the credit of

[3] "The last days of July [1914] were certainly very difficult, and the organization of the banks, so far-reaching in its ramifications, passed through a severe trial, which it surely would have been able to surmount without any break in its machinery, if it had only been possible to receive the remittances due from abroad. It was the non-appearance of these which resulted in an actual money crisis. The sensitive discount market collapsed, as the accepting houses would soon be unable to pay their—on foreign account—accepted bills, because their customers did not send cover."—*The City*, Sonne.

the Bank of England in Canada, by New York bankers, to meet a large volume of maturing New York City bonds.

*Governmental Protection to Bank of England*

The most telling remedy invoked in this extraordinary crisis was the act of the British government in agreeing to indemnify the Bank of England against loss in discounting bills accepted prior to August 4. Immediately, the bills, which had been a dead weight in the hands of their holders, were thrown upon the Bank, whose "Other Securities" rose from £65,351,656 on August 7 to £121,820,692 on September 2. This and other measures were so effectual that it has been estimated[4] that of the £350 to £500 million of bills running at the outbreak of the war only about £50 million would remain unpaid at the end, chiefly because the debtors belonged to hostile countries, and on this unpaid sum a substantial recovery is not improbable.

Various devices were resorted to in disentangling the situation in the respective countries, government intervention being relied on chiefly. In Russia an arrangement was made whereby merchants were able to buy sterling at a fixed rate, the funds being provided by the sale of Russian Treasury bonds in London.

*Foreign Bills a Profitable Bank Investment*

From the pure banking standpoint the object of handling these bills is the profit derived from the discounts or commissions charged. They constitute a prime type of banking paper, even the so-called "finance bills" being usually drawn against adequate collateral and by houses of established standing. But in addition to the protection afforded to the exchange rate, and to the gold stock of a country, these bills constitute a form of international currency of great service in carrying on the world's trade.[5] This service is performed without converting into fixed capital the commitments it requires, the most liquid form of credit known being employed.

[4] Sonne, *The City*.

[5] "The justification of the English accepting houses and bill brokers and banks (in so far as they engage in this business), is the fact that they are assisting trade and could not live without trade, and that trade, if deprived of their services, would be gravely inconvenienced and could resume its present activity only by making a new machinery more or less on the same lines."—*International Finance*, Hartley Withers.

Additional to the influences already recorded, the holding of a choice line of foreign bills constitutes a ready means of enlarging the lending powers of a bank. Indeed, it has come to be the custom of some banks to regard bills of this character as virtually constituting a part of their reserves. Theoretically this may be going too far, but in practice a bill immediately convertible into cash does constitute at least a secondary form of reserve. This quality of the foreign bill stamps it as a most important element of the financial mechanism, by whose judicious use great flexibility can be assured in a bank's lending operations or even in those of the banks of an entire country, where a central bank or some other specially-designed piece of financial machinery acts as a monitor of the international money market.

The enormous benefit that may accrue by the accumulation of short-time obligations was shown most strikingly in the case of the payment of the war indemnity exacted by Germany from France at the close of the Franco-Prussian War. More than 5,315,000,000 francs were paid and only 275,000,000 francs in French coin left the country.

When heavy payments are to be made abroad, the work of accumulating exchange is sometimes spread over considerable periods so as not to cause disturbance and occasion a rise in price. The payment of $50,000,000 by the United States for the rights of the French Company in the Panama Canal was at least partly made in this way.

Another useful purpose of accumulated trade credits is shown in the following statement:[6]

> The Japanese purchase of approximately $30,000,000 British Treasury bills, paying for them in American funds on deposit here, is one of the interesting developments of war financing. Japan has built up a credit in this country by balance on her trade with us—by selling us more goods than we have sold her. The most important item in this trade was raw silk, of which we took from her this year 169,000 bales—an increase of 20,000 bales over 1913–14. About $50,000,000 of this favorable balance is said to have been on deposit in New York, and out of this the $30,000,000 was paid to Great Britain, but the amount did not leave this country and is being used to pay us for purchases by Great Britain.

### *Attack on Our Gold Reserves After the War*

In Europe the practice of accumulating foreign bills in the possession of the great central banking institutions is quite common.

[6] *The Bache Review*, New York, Aug. 19, 1916.

These bills are bought when the rates are low and disposed of when they are high, thus tending to counteract the conditions leading to the exportation of gold. It is in this respect that the great New York banks, and perhaps the Federal Reserve Board, will doubtless find it advantageous, as opportunity offers, after the close of the war, to gather up a large volume of foreign bills for use in parrying the attack on America's gold reserves which many regard as sure to follow the closing of the war. There are some who fear this attack may be so severe as to endanger the maintenance of the gold standard itself. They base this fear upon several factors:

First.—The character of the various forms of "money" available as bank reserves, under the law.

Second.—The nature of the Federal Reserve Act, which places the direction of the larger affairs of banking and finance in the hands of men appointed by the President, and therefore under some political restraints which might prevent them from acting as freely or effectually as a private bank.

Third.—That following the war, in order to build up their shattered industries, to reduce their currencies more nearly to a metallic basis, and to effect a general reconstruction of their disordered finances, the European belligerents will enter into a desperate struggle for the world's gold.

Fourth.—That the United States will most likely undergo a sharp change in its economic position in the near future, losing much of its newly-gained foreign trade other than that represented by the export of war materials (the latter trade being cut off altogether), and experiencing a severe recession in domestic business activity.

### *The Probable Effects*

Taking up the latter contention first, while it undoubtedly contains considerable truth, it ventures too far into the realm of prophecy to be accepted as an accurate representation of what will happen. It would be quite as good a guess to say that we shall retain a very considerable share of our new foreign trade, and that domestic business, influenced by a succession of good crop years, will continue active.

As to the struggle for gold, it will probably take place, and it is difficult to see how America can retain its present stock. No one expects that anything like the current abnormal balance of exports

can be maintained. On the other hand, we shall not for a long time, if ever, pay as much to Europe on account of principal and interest on our securities. Tourists' expenditures, and some other items which enter into the international financial balance, will be as large, and perhaps larger, than heretofore. If Europe can produce and sell cheap enough to menace our domestic industries through "dumping," this difficulty will no doubt encounter a tariff barrier. Europe still holds a large amount of our securities, and may find it advisable to part with more of them than have already been sent over.

The objection to the semi-political composition of the Federal Reserve Board may or may not be valid. That can only be determined by time. Presumably, even from the standpoint of politics, the Board will endeavor to shape its policy wisely and for the public good. A central bank could not do more than that, although it might be a little more prompt and vigorous in its application of remedies and a little less sensitive about criticism.

The first factor may prove the one of greatest importance. This country has not yet adopted the sound economic policy of establishing its banking credits upon gold alone. There are now available as bank reserves the following forms of "money," in substantially the amounts named: Legal-tender notes, \$346,000,000; national bank notes, \$682,000,000; silver, \$568,000,000; Federal Reserve notes, \$190,000,000—a total of more than \$1,700,000,000. The legal tenders and the silver may be counted as part of the lawful money reserves of the national banks, while these and all the other forms of currency named are quite generally used for the reserves of the more numerous state banks. In the face of a severe world-wide struggle for gold, such as some people are expecting when the war ends, it becomes a question, particularly should trade and enterprise slacken here, whether Gresham's law would not become operative and deprive us of a large part of our gold stock.

## II. Short-Term Obligations

A form of investment practically new to our money market has come into being since the beginning of the war—the short-term obligations of foreign governments. Prior to the European crisis we had made some loans to Canada and a few to several foreign countries, but these latter were of a somewhat spectacular

and temporary character. They were subscribed for more or less in a spirit of financial bravado—to show London what we might do if once we took the notion. But having thus gratified our financial vanity, we were quite content to dispose of the loans allotted us.

The loans made to Europe in the last two years are of an entirely different character. They have been made in all seriousness. France and Great Britain have needed our financial help. Other countries, long in the habit of borrowing from these financial giants, were compelled to turn here to make fresh loans or to renew old ones. But we ourselves were virtually compelled to make these loans, or to see American export trade seriously curtailed.

### *Our Investments in Short-Term Obligations*

To what extent we have already entered upon the policy of investing in foreign short-term obligations may be seen from the accompanying statement:

| | |
|---|---|
| Anglo-French five-year 5s | $500,000,000 |
| British Government two-year 5s | 250,000,000 |
| British Bank loan | 50,000,000 |
| French three-year loan | 100,000,000 |
| French one-year notes | 30,000,000 |
| French special credit | 55,000,000 |
| Canadian Government | 120,000,000 |
| Canadian municipalities | 120,000,000 |
| Italian Government one-year notes | 25,000,000 |
| German Government notes | 35,000,000 |
| Swiss Government notes | 15,000,000 |
| Swedish Government notes | 5,000,000 |
| Norwegian Government notes | 8,000,000 |
| Argentine Government notes and bonds | 75,000,000 |
| Panama, Bolivia, and Costa Rica Government notes | 4,500,000 |
| Yucatan Government bonds | 10,000,000 |
| Russian Government acceptances | 25,000,000 |
| Russian Government credit | 50,000,000 |
| Chilian Government bank loan | 10,000,000 |
| Greece | 7,000,000 |
| Panama | 3,000,000 |
| Newfoundland notes | 5,000,000 |
| Total | $1,502,500,000 |

Since this compilation was made, some additional loans or credits have been reported, and it may reasonably be expected that the above total will soon rise to $2,000,000,000.

The chief benefit flowing from loans of this character, under normal conditions, consists in the command they give the lending nations over goods they need for consumption or for raw materials which enter into the manufacture of goods either to meet the home demand or for export. It need hardly be explained that capital is exported chiefly in the shape of goods, and that the principal and interest of capital borrowed are returned largely in the same manner. In other words, goods are wanted, not gold. Or, as recently said by Sir George Paish:[7]

> Our accumulated wealth for the greater part consists of the machinery of production, using the term in its broadest sense, of use for the purpose of production, but unavailable for any other purpose than production. Beyond the wealth we have built up at home in this manner, we have invested abroad a very large sum of money, and for all practical purposes this is the only part of our accumulated wealth that we are able to turn into consumable goods in order to supplement the nation's own productive power and income.

*Their Use in Emergencies*

But there may come a season when the shipment of goods to a country may be satisfied for the time being. There may exist an "adverse" trade balance which cannot be liquidated in merchandise. Gold will therefore flow out. It is at such a juncture that the possession of foreign bills, arising out of previous favorable conditions of trade, or possibly "finance" bills drawn against such an emergency, or short-term, foreign bonds, notes or credits, will serve a most useful purpose. They will fill the gap and prevent the exportation of gold, for they must either be paid or renewed.

The value of investing in short-term foreign loans has been thus clearly stated:[8]

> We may invest in short-term foreign loans that can be converted into credits to check a gold demand. We have already done some of that and will probably do a good deal more. There have been bankers so short-sighted as to object to our making any loans abroad, but I believe the day will come when you will find that those loans, convertible into credits, as they will be, will check gold withdrawals and form one of the most important safeguards of our gold stock.

The advantages of becoming a lending nation are well illustrated in the financial and commercial history of France and Great Britain. Such a policy has made their wealth cumulative. A most

[7] "War Finance," *Journal of Royal Statistical Society*, May, 1916.

[8] *Some Elements of National Foreign Trade Policy*, Frank A. Vanderlip.

striking witness of the value of having large foreign investments was given by the recent British loan placed in our markets. Under the extraordinary conditions now existing Great Britain could not have borrowed here at a favorable rate, if at all, without collateral. That collateral was offered, in abundance and of unquestioned character, because British investors had accumulated large holdings of the world's choicest securities.

By investing abroad the United States will greatly aid in the work of reconstruction after the war, and will also help in supplying nations not engaged in the strife with capital they would otherwise have obtained from the belligerents. Furthermore, we shall lay a basis for materially enlarging both our exports and imports, for capital exported will go to a large extent in the shape of the goods the borrowing countries require, just as the interest returns on our loans will come to us in the shape of goods we need and do not produce ourselves. Most of all, if we are to have the great attack upon our gold stock which many foresee, a goodly volume of foreign bills and short-term obligations in our possession will serve as a shield against such an assault.

Whether we are yet ready to share permanently in the field of international financial operations on any large scale is a matter which time alone will determine. But there can scarcely seem a doubt of the wisdom of safeguarding the near future by judicious short-term foreign investments.

# THE EFFECT OF THE WAR ON NEW SECURITY ISSUES IN THE UNITED STATES

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The European war has thrown a tremendous burden upon the investment markets of the United States. In addition to the problem of making a place for new security issues of established corporations and of financing new enterprises, American investment bankers and their customers have been face to face with the necessity of purchasing an enormous aggregate of securities of American corporations heretofore held in foreign countries, and of absorbing over one billion dollars of the bonds of belligerent governments.

There is a limit to the amount of securities which the investors of a country can absorb. This limit, in the last analysis, is determined by the aggregate savings of business and professional men, added to the reinvestment of income derived from dividends and interest. It is an axiom of finance that when the supply of securities offered exceeds this amount a portion of them cannot be marketed. These undigested securities, as they are frequently termed, remain in the hands of underwriters and promoters, or clog up the collateral loans of banks, frequently laying the foundation for panics and other serious financial disturbances. When the investment market shows signs of an over-supply of securities, those least favored or offered on the most unfavorable terms, are passed by. The promotion of new enterprises is curtailed. Corporations postpone entering the financial market for new capital to finance extensions and improvements. In brief, the output of securities is diminished until the market is able to absorb a larger supply.

## Volume of Securities Issued During the War

Has the output of securities in the United States been decreased as a result of the European war? The record of new

security issues for six years preceding the beginning of the European struggle and since that time, so far as available, follows:[1]

NEW SECURITIES ISSUED IN THE UNITED STATES

*(In thousands of dollars)*

| Year | Corporate | Municipal's, etc. | Total |
|---|---|---|---|
| 1908 | $2,584,396 | $313,797 | $2,898,194 |
| 1909 | 3,247,609 | 339,424 | 3,587,034 |
| 1910 | 3,485,890 | 320,036 | 3,805,926 |
| 1911 | 3,576,919 | 396,859 | 3,973,778 |
| 1912 | 4,548,759 | 386,551 | 4,935,311 |
| 1913 | 3,179,990 | 403,246 | 3,583,236 |
| 1914 (Jan.–June) | 1,580,460 | 355,998 | 1,936,459 |
| 1914 (July–Dec.) | 751,004 | 110,376 | 861,381 |
| 1914 Total | 2,331,465 | 466,375 | 2,797,840 |
| 1915 (Jan.–June) | 1,335,721 | 320,394 | 1,656,116 |
| 1915 (July–Dec.) | 1,625,887 | 167,567 | 1,793,454 |
| 1915 Total | 1,961,609 | 487,961 | 2,449,571 |
| 1916 (Jan.–June) | 2,807,056 | 275,740 | 3,082,796 |
| 1916 (July–Dec.) | 613,780 | 57,739 | 671,520 |
| 1916 Total | 3,420,837 | 333,480 | 3,754,317 |

The security market was slow in recovering from the effects of the panic of 1907, and we, therefore, find a steady and rather remarkable increase in the volume of securities floated in the years 1908, 1909 and 1910. The maximum security output was reached in 1912 when nearly $5,000,000,000 of securities were floated. At this point the security market suffered a curtailment, and in 1913 security issues aggregating only $3,500,000,000 were brought out. The record from that date is significant as reflecting the influence of general business conditions on the security market. In the first six months of 1914 a little less than $2,000,000,000 of securities were marketed. During the last six months of the same year, after the outbreak of the war, financing fell off to $861,000,000 making a total of considerably less than $3,000,000,000 for the year. It is true, however, that in normal times, the last half of the year is less

[1] The figures for corporate securities were compiled from Babson's Desk Chart. The data concerning municipal issues were compiled from the *Commercial and Financial Chronicle.* The above computation takes no account of the repurchase of American securities held abroad, of the government loans effected by the European belligerents since August, 1914, or of issues of new corporations outside of the eastern states.

active in this line than the first half. During the first six months of 1915, or the second half-year of the war, there were issued over $1,600,000,000 of securities. In the second half of 1915 nearly $1,800,000,000 were brought out, the steady increase being due to the revival of business, caused by the industrial activity created by enormous war orders placed by foreign powers. During the first six months of 1916 we find the security market extremely active, over $3,000,000,000 of securities being issued. July and August of 1916 reflect the same conditions as prevailed in former years with new financing slightly decreased. During August the flotation of motor stocks constituted a large part of the new financing. It must be remembered that the figures given on page 119 are not complete, for it is impossible to cover all new issues of securities. While a prophesy is dangerous and in most cases fruitless, yet unless there is a distinct change in financial conditions, the output of new securities in 1916 will closely approximate, if it does not exceed, the high water mark of 1912.

A review of the above comparison shows, in brief, that the first shock of the war radically curtailed the volume of new security issues, but under the stimulating influences which have existed since the advent of war orders and the return of industrial prosperity, the power of absorption of new securities is as great as in any previous period of our history. This record is all the more astonishing when we consider that since August, 1914, American investors have been called upon to absorb in addition over $1,740,000,000 of European war loans and approximately $1,300,000,000 of American securities formerly held abroad.

### AMERICAN SECURITIES RETURNED TO OUR MARKET

Let us first take up the resale of American securities by foreign investors in the American market. The only accurate information at hand concerning foreign holdings of American securities is that compiled by President Loree, of the Delaware and Hudson Company.

Mr. Loree's figures give the par value of American railroad securities held abroad at different dates. Industrial or American municipal securities are not included in the figures submitted. One hundred and thirty-six railroad companies reported securities held abroad. On January 31, 1915, $2,704,402,364 in par value of

AMERICAN RAILROAD SECURITIES HELD ABROAD ON AUGUST 1, 1916.

| | Par value | | | Market value | |
|---|---|---|---|---|---|
| Class of securities | July 31, 1916 | July 31, 1915 | Jan. 31, 1915[1] | July 31, 1916 | July 31, 1915[2] |
| Preferred stock... | $120,597,750 | $163,129,850 | $204,394,400 | $93,816,715 | $117,863,393 |
| Second pref. stock | 4,858,650 | 5,608,850 | 5,558,150 | 2,060,256 | 2,115,415 |
| Common stock... | 336,761,704 | 511,437,356 | 573,880,393 | 234,154,103 | 342,225,958 |
| Notes............ | 9,070,955 | 24,632,292 | 58,254,390 | 6,844,240 | 22,574,284 |
| Debenture bonds. | 74,796,900 | 160,288,700 | 187,508,310 | 69,858,284 | 141,444,593 |
| Coll'tl trust bonds | 85,166,470 | 180,590,850 | 282,418,415 | 66,526,692 | 136,422,186 |
| Mortgage bonds.. | 774,793,834 | 1,150,339,130 | 1,371,156,851 | 628,183,797 | 962,081,613 |
| Equip. trust bonds | 7,788,300 | 25,253,201 | 20,233,455 | 7,015,683 | 24,480,410 |
| Car trusts....... | 836,000 | 29,000 | ............. | 681,320 | 29,060 |
| Receivers' certifi's | 958,000 | 2,201,000 | 998,000 | 958,000 | 2,201,000 |
| Total....... | $1,415,628,563 | $2,223,510,229 | $2,704,402,364 | $1,110,099,090 | $1,751,137,912 |

[1] Market value as of August 2, 1915.
[2] No market value determined for first compilation.

American railway securities were held by foreigners. By July 31 of the same year the amount so held was reduced to $2,223,510,229, showing that approximately $500,000,000 were disposed of during these six months. The last figures obtainable, as of July 31, 1916, show that all but $1,415,628,563 have been liquidated. From a study of these figures we see that nearly one-half of the railroad securities held by foreigners have come into American hands during the last eighteen months. If account is taken of industrial securities, municipal bonds and railroad securities owned abroad but standing in the name of American bankers holding them as agents, it is estimated that between $1,500,000,000 and $1,750,000,000 of American securities have been returned from abroad since the outbreak of the war, two years ago.

## NEW FOREIGN LOANS FLOATED HERE

The American investment market has been called upon to absorb between $800,000,000 and $1,000,000,000 of foreign-held securities a year. In view of the large output of new securities by domestic corporations, this record is most remarkable. But even this tremendous volume of securities does not measure the extent of the market which has prevailed during the last two years, for it does not take into consideration the floatation of the various loans in the United States by Canada, the Latin Americas, or the belligerent nations of Europe. The record of such financing, in so far as ascertained, is as follows:

| | |
|---|---|
| Europe | $1,300,000,000 |
| Canada and Newfoundland | 335,000,000 |
| Latin America | 105,000,000 |
| Total | $1,740,000,000 |

This estimate indicates that there has been floated in the United States since the outbreak of the European war over $1,740,000,000 of foreign public loans.

Has the foreign liquidation and the financing of the belligerents curtailed the financing of American corporations and municipalities? From the available data, the question must be answered in the negative, for the records show that more securities have been issued than was the case in the year preceding the war. It might be urged that a comparison based on the total issues of securities of all kinds, such as has been used, is not a fair index of the extent of the security market or of the degree to which the war has affected those securities which are entitled to rank as investments. A large proportion of the total capitalization represented in the above table is of a speculative nature. This portion represents the securities of new industrial corporations which have not established themselves as business enterprises, and where the capitalization is, therefore, in large part nothing but a claim to a share of anticipated profits, and to a good will of unknown value. If we separate railroads and industrial security issues and compare them by six-months' periods, we find that no facts are disclosed which impeach the conclusion that the security market has been one of large capacity.

The following table compiled by *The Journal of Commerce* classifies the financing of railroads and industrials for the six months (actual issues) and gives comparisons with a year ago.

RAILROADS

| | 1916 | 1915 | Change |
|---|---|---|---|
| Bonds | $270,281,300 | $331,475,300 | −$61,194,000 |
| Notes | 209,205,000 | 135,708,800 | + 73,496,200 |
| Stocks | 26,203,400 | 5,485,000 | + 20,718,400 |
| Total | $505,689,700 | $472,669,100 | +$33,020,600 |

Industrial Corporations

| | 1916 | 1915 | Change |
|---|---|---|---|
| Bonds | $300,232,300 | $159,194,500 | +$141,037,800 |
| Notes | 160,286,100 | 84,468,500 | + 75,817,600 |
| Stocks | 368,373,100 | 51,842,500 | + 316,530,600 |
| Total | $828,891,500 | $295,505,500 | +$533,386,000 |
| Grand total | $1,334,581,200 | $768,174,600 | +$566,406,600 |

The real effect of the European war upon the sale of securities by established American corporations has been to compel a higher interest rate. Large corporations have been compelled to compete for money with the foreign governments, which have been constantly increasing the rate which they will pay. With European war loans selling on a $5\frac{1}{2}$ per cent basis or better and with Canadian loans marketed at prices yielding the investor above 5 per cent, it is obviously difficult, if not impossible, to market railroad bonds on a 4 per cent or $4\frac{1}{2}$ per cent basis. As a matter of fact the most noticeable feature of American corporate borrowing has been the higher yields offered to the investing public. There is nothing in the situation at the present time which would support the conclusion that the end of this movement has been reached.

## The Disposition of These Securities

Have the investors of the United States absorbed the additional capital issues of American corporations and municipalities, the European liquidation of American securities and the foreign war loans floated in this country? If such absorption has occurred the general investment situation must be regarded as sound, but if, on the other hand, a considerable proportion of one or all of these groups remains unabsorbed, the situation must be regarded as unhealthy. Securities are not really marketed until they are actually sold to the investor. So long as they are in the hands of the underwriters or investment bankers they constitute an element which may prove dangerous in case of financial disturbance. In most cases securities in the hands of bankers and underwriters are pledged with national, state or private banks as collateral for loans, which is another way of saying that the money to purchase them from the corporations has been largely borrowed. An undue expansion of collateral loans would, therefore, be regarded as an unfavorable

symptom and indicative of the fact that the American investing public are being fed with securities faster than they can be absorbed. Unfortunately data concerning collateral loans of the national and state banks are not available for a later date than June 30, 1915. There is no way of telling at the present moment what expansion has occurred in this class of loans during the succeeding fifteen months.

### Collateral Loans of Our Banks

The collateral loans of the state banks for the year ending June 30, 1915 (covering the first ten months of the war) expanded $133,000,000 over the loans reported in the previous year. The collateral loans of the national banks on June 30, 1914, aggregated $2,409,805,178, of which $1,036,976,740 were demand loans and $1,372,828,438 were time loans. On June 30, 1915, the total collateral loans aggregated $2,633,326,003. The increase occurred entirely in time loans, which would lead to the assumption that there was a larger "carry" of securities by investment bankers. It is not safe to presume, however, that the collateral loans entirely represent securities being thus carried. A large proportion of these loans represent the borrowing of business men and others for the purpose of financing their enterprises. Collateral loans of the national banks increased in volume from June, 1913 to June, 1914 some $241,000,000. The increase in collateral loans in the year ending June, 1915 was $224,000,000. It is reassuring to know that there was no unusual or abnormal increase in this year.

Much speculation is heard as to whether collateral loans have unduly expanded in the twelve months ending June, 1916. It is likely that there has been considerable expansion. An analysis of this expansion would to a large extent indicate whether America was carrying an unusual amount of undigested securities.

### Their Investment Holdings

In this connection it is interesting to analyze the investment holdings of our banking institutions. National and state banks, trust companies, private and savings institutions constitute one of the largest classes of bond buyers. If we group the banks outside of the national banking system, that is to say, the state, mutual savings banks, private banks, and loan and trust companies, we

find that over a period of five years ending June, 1915, their holdings of state, county, municipal, railroad, public utility and other bonds—except United States bonds—have increased from $1,112,-553,992 in 1911 to $1,346,613,857 in 1915. It is impossible to say what changes have occurred in this account for the year ending June 30, 1916.

The national banks in June, 1913, held $1,050,587,650 of bonds, other than United States bonds. According to the last statement preceding the outbreak of the war, June, 1914, the bond holdings aggregated $1,015,981,900. A year later the total bond holdings were $1,191,128,000. In June, 1916 the bond holdings were $1,528,-832,000, an increase in twelve months of $337,704,000. In the same period deposits increased $1,500,000,000 and the total resources of national banks increased $2,100,000,000. Certainly it could not be contended that an increase in bond investments of the amount indicated above is excessive, in view of the tremendous growth in deposits and resources of national banks.

## The War and Financial Conditions

With this general review of the statistical progress of the security market we turn to a more detailed examination of the effect of the war upon investment conditions. It will be remembered that the first important effect after the outbreak of the war and continuing for practically all of the last five months of 1914 was the paralysis of the investment market which did not resume any activity until after the opening of the stock exchange on November 28. Foreign commerce was demoralized. It was not until one power controlled the sea that we find it again on the upward trend. The foreign exchange situation became very acute and developed to a point where the American dollar had greatly depreciated in terms of the English pound. This situation was greatly relieved by the operation of the $100,000,000 gold pool and the exportation of gold in large quantities from the United States to England and Canada. This embarrassing foreign exchange situation was brought about by the falling off in our exports and also by the effect of the moratoria declared by the various belligerent nations. Americans were forced to pay debts abroad which were due, but on the other hand were not receiving remittances of debts due by foreign merchants. Later the foreign exchange situation was reversed. Even though

the moratoria in some cases were extended, the large exports of American goods called for payments which the foreigner was not meeting with the shipment of commodities, but was forced to meet with shipments of gold. England and France were very unwilling to release any large part of their gold holdings for it reduced their ability to extend credit, and finance war obligations in their own country. Hence English and French merchants were forced to pay a very high price for bills of exchange with which to settle their debts in the United States.

The situation became serious. Although the United States was the recipient of large importations of gold, even this did not check the fall in sterling exchange, and it was not until the flotation of the $500,000,000 Anglo-French loan in this country that sterling exchange recovered to any extent. Even at this time the English pound is greatly depreciated in terms of the American dollar, but due to further credits arranged with American bankers, the pound sterling has not fluctuated widely. Even though quotations do not resemble normal times, the difference does not lie wholly in the visible balance of trade.

Following the close of the London and New York stock exchanges and the paralysis of our foreign commerce, we find a complete disorganization of American business. Bankers were not prone to encourage extensive business operations at this time, nor was the business man anxious to increase his facilities, for in many cases he found himself with large stocks of goods on hand and little work for his plant because of cancelled orders. This condition necessarily led to unemployment and a consequent flooding of the labor market. Manufacturers were not making money and business suffered a depression which is sometimes referred to as the depression of 1914. In this depression many companies lowered and in some cases suspended their dividends. This destroyed the basis of financing new issues.

## Effect on the Markets

The bond market reflected this condition. It is very difficult to determine to what extent the prices of securities fell, because of the "pegged" quotations during the suspension of stock exchange operations. Generally the tone was not optimistic. With the placing of large war orders business was revived in certain industries,

and soon acted as a general stimulus to all trade. The manufacturer found himself in the position where he could sell at his own price, instead of at a bargain, and this situation necessarily meant larger profits. The labor market was directly affected, for the demand for labor was steadily increasing, and the growing assurance that America could withstand the strain and irregularities caused by the European struggle brought about a return of public confidence. The opening of the stock exchanges marks the end of the period of fear and distrust. The banks had large surplus reserves and money was very cheap, so that the American manufacturer was able to finance his operations at a low cost, so far as short-term loans were concerned. When the foreign exchange situation turned in our favor, that is when sterling exchange crossed the par point, it signified that our commerce was moving in sufficient volume to liquidate our indebtedness and that we were able to realize on goods which had been tied up temporarily and also on new goods which were being manufactured on foreign order.

At this time the investor was looking for bargains in securities. He anticipated heavy European liquidation of standard securities at low prices, and even though banks were making short-term loans at low rates, it was very difficult for the railroads of the United States to float long-term issues. Therein comes the distinction between floating and permanent or fixed capital, for while the banks were lending at comparatively low rates the investment market was looking for a higher yield, which prevented normal issues of new capital from being sold. The railroads were not strongly bidding for investment funds because the business depression was still continuing to a diminishing extent, and they had not as yet shared in the prosperity which had affected but few industries. Judging from the idle car figures, and also from earnings, the railroad situation was becoming worse from month to month as the war continued. It was not until the early summer of 1915, according to the foregoing barometers, that they began to share to any appreciable extent in the activity of American commerce. Since that time, with the exception of the month of June, the number of idle cars has decreased until at the present writing figures indicate that a car shortage is imminent.

### RAILROADS, PUBLIC UTILITIES AND MUNICIPALITIES

The fact that the railroads had a great many idle cars also signified that their terminal and track facilities were not wholly used and hence they did not need new capital in large amounts to extend such facilities. Operations under construction at the beginning of the war were in many instances discontinued or curtailed. Generally new propositions were not undertaken for two reasons: first, because of the period of uncertainty; and second, because of the inability to get capital on favorable terms, since the American investor was holding off to wait for bargains in American securities held by foreigners rather than buy new securities issued for the extension of work in the United States.

Practically the same situation existed in the public utility field. Street railway earnings were lagging which is usually the case during any period of unemployment. The working man was not riding as frequently, and the earnings of electric light and gas companies were directly affected because the public was economizing. This is especially true in certain localities particularly the middle west. These factors stunted the demand for new capital to be used for additions and extensions in this field. However certain standard properties, of which the Detroit-Edison is an example, successfully disposed of securities during the period. In most cases these securities had a vogue due to the established business of the issuing company.

The market in municipals was slow. This market is largely an institutional market and quickly reflects general business conditions. In periods of depression there is a falling off in savings and a hesitancy to invest in a falling bond market. With the improvement in labor conditions and an increased prosperity in the industrial field we find this market improving.

During the year 1915 the United States was called upon to finance foreign governments. Canada, which theretofore had disposed of practically all of its securities in England, turned to us in order to sell its public bonds. The proposition which they offered was very attractive, because of the high interest rates. American bankers also took Argentine loans aggregating $79,000,000.

War orders had given tremendous impetus to American business. The Allies were buying at a rate of which the public had no conception. It will be remembered what a sensation the size of the

Anglo-French loan caused, for it disclosed in part the huge operations which America was conducting for the allied powers. Continuous liquidation of foreign-held American securities kept the prices of railroad stocks and bonds down. These foreign security holdings were very attractive, first, as to price, and second, because the railroads were now showing a better margin of earnings, and therefore, were a safer investment than heretofore.

The continued importation of gold increased the lending power of our banks enabling the easy money market to continue. The industrial boom meant profits to the manufacturer and it may be safely assumed that the business man absorbed a great many securities, for the business man's investments are determined by his profits. The Anglo-French loan was underwritten with apparent ease, but the syndicate could not liquidate fast enough without beating down the price of these securities. If the syndicate had been any less powerful, the loan probably would not have been absorbed so quickly. The underwriters took their shares at once, gradually disposing of the bonds as a market could be found for them among individual investors and later we find part of the loan being disbursed as dividends by manufacturers of explosives.

### Absorption of Securities A Serious Problem

Experience showed that the American investor was slow to take the securities of foreign governments, for he feared repudiation, and, moreover, expected collateral security which has been the basis for issuing some of the later loans.

Tremendous speculation in industrial shares, especially in stocks of manufacturers of munitions and automobiles, brought into being industrial combinations and new companies. This marked a period of increasing prices in stocks, but a careful study of our general security market reveals the fact that with the exception of the "war stocks" the rise has not been as general as people have been made to believe. The year 1916 opened with a continued good bond market lasting throughout the first six months. Early in 1916 the municipal bonds and public securities generally were very popular because of the income tax regulation exempting them from taxation. Bank interest rates were higher than before the war. Continued European liquidation did not seem to affect the market for new securities. The period is also marked by additional

financing of European powers. The later foreign loans and the liquidation of foreign-held American securities have had to compete with new issues of railroad, public utility and other corporate securities issued at higher rates of interest, which absorbed a large part of the investment fund of the United States.

As to the future no one can prophesy what will happen in the investment market. War orders are continuing, but increased wages and the forcing of shorter hours upon American business have increased the cost of production and doubtless decreased profits. An increased demand has raised the cost of raw materials, therefore directly affecting the situation. Nevertheless, the country is very prosperous and the investment fund necessarily large. If the European liquidation goes on to the end it may stunt the market for new securities of railroads and public utilities, but in view of the increased business in the United States we have reached the point where we must have new fixed capital in these industries, therefore, increasing competition between these two groups of securities may be expected. It is very likely that a large part of the current sluggishness in the American security market, if it can be called sluggish, is due to labor troubles. This situation makes the investor pessimistic and leads to market uncertainty. Large investment bankers avoid commitments fearing that market conditions may radically change before they can sell that which they have bought. The writer has purposely omitted any discussion of the Mexican situation and also the national political situation as influencing the marketing of new securities in the United States.

In conclusion several effects may be noted. American corporations have lost the investment fund of foreign countries. The United States is practically dependent upon the investment demands of its own people. In addition to financing local necessities we doubtless must absorb securities formerly owned by foreign investors. As this is accomplished we are gradually converting our country into a creditor nation. The railroads have suffered, because of the competition which their securities have had to meet, at certain periods during the war. It is possible that this class of security will have to be offered on a more attractive basis. In the long run it should be comparatively easy to finance American enterprises entirely with American capital.

# FINANCING AMERICAN WAR ORDERS

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War orders have revolutionized America's position in international affairs. In point of age and development, the United States is a young country. It is scarcely two generations since the west was settled. We have needed large amounts of capital—more than could be provided from the savings of our people. Our natural resources, favorable climate and energetic population have furnished a combination which has been attractive to investors of all nations. The great commercial nations of Europe, especially England, France and Germany, have in the past years invested enormous amounts of money in this country. America, therefore, might be compared to a thriving, growing industrial plant for the construction of which large amounts of money had to be borrowed and on which there still remains a large mortgage. The plant has earned large profits, enabling it not only to pay interest upon the borrowed money but to return handsome dividends to its stockholders. War orders are enabling America to pay off rapidly the mortgage on the plant. We are ceasing to be a debtor nation and are approaching the position where we will become one of the great creditor nations of the world.

Whatever may be the merits of the question as to whether the United States is preserving neutrality in selling munitions of war to one set of belligerents, the other being debarred because of the blockade, there can be no doubt that, from an economic standpoint, America is one of the strongest factors in the Allies' struggle. Without her material assistance, the chances of success for the Allies would be perhaps hopelessly reduced. The workshops of America have turned out an enormous supply of goods of every character directly or indirectly employed in warfare. Every American workman engaged in such work is taking the place of a citizen of a belligerent country who would otherwise have to remain at home in the factories in order that the necessary munitions

might be produced. American workmen, in this sense, therefore may be regarded as substituting for European soldiers. It is not the purpose of this article, however, to deal with the international aspects of the munitions business. The question is one for determination according to the principles of international law. However, it is important for us to understand the reason why the Allies turned to the United States, just as the central powers would have done were they able to control the seas—for supplies of munitions.

### THE IMMENSE VOLUME OF WAR MATERIALS EXPORTED

It is almost impossible to determine the exact extent of the war orders which have placed in America. They surpass in volume anything imagined prior to the European conflict. The sudden outbreak of war paralyzed American business. A large proportion of the English merchant marine was requisitioned for military purposes. German shipping was driven from the seas. What in substance amounted to a blockade was established around Germany, cutting off one of our largest foreign customers. Thousands of men were out of employment. Relief committees and other philanthropic organizations were swamped with demands for assistance to the unemployed. The paralysis of international exchange, the closing of the stock exchanges throughout the entire world, and the dislocation of trade relations affecting most of the civilized countries profoundly depressed all forms of business enterprise. Factories were running on part time or were completely shut down. These conditions were peculiarly favorable to the nations urgently in need of war munitions of every character. American manufacturers were anxious to do business; work upon orders could be undertaken at once. Thus it happened that within a few weeks after the outbreak of the war, America's industrial condition began to be revivified by the injection of war business which has since become the outstanding feature of our commercial and industrial life.

The extent of war orders and the influence which they have exerted upon industrial conditions in this country can be understood if we set down for comparison the amount of goods of this character which had been exported prior to and since the outbreak of the war. We will first make a comparison of the exportations of those articles which are obviously used in military operations:

| Articles Exported | Twelve Months Ending June 1914 | 1915 (Value.) | 1916 |
|---|---|---|---|
| Horses | $3,388,819 | $64,046,534 | $73,531,146 |
| Mules | 690,974 | 12,726,143 | 22,946,312 |
| Horse shoes | 98,835* | 2,001,258* | 2,135,079* |
| Aeroplanes and parts of | 226,149 | 1,541,446 | 7,002,005 |
| Automobiles and parts of (not including engines and tires) | 33,198,806 | 68,107,818 | 120,000,866 |
| Automobile tires | 3,505,267 | 4,963,270 | 17,936,227 |
| Railway cars, carriages, motor cycles, bicycles, wheelbarrows and hand trucks | 51,676,222 | 85,108,341 | 167,742,608 |
| Explosives | 6,272,197 | 41,476,188 | 467,081,928 |
| Barbed wire | 4,039,590* | 7,416,389* | 23,909,209* |
| Boots and shoes | 17,867,234 | 24,696,795 | 47,134,810 |
| Harness and saddles | 786,455 | 17,460,519 | 7,529,720 |
| Firearms | 3,442,297* | 9,474,947* | 18,065,485* |
| Surgical appliances, including instruments | 1,494,888 | 4,979,044 | 3,521,888 |
| | $118,900,590 | $324,545,357 | $933,632,002 |

*In footing the totals, duplications, indicated above by (*), have been avoided.

In passing it should be noted that war broke out in Europe on July 28, 1914. By comparing the value of exports of each of the articles enumerated above for the twelve months ending June 30, 1914, with the amount exported in the two succeeding years, the extent of the stimulus which war has imparted to those industries can be measured. It will be seen that whereas in the year ending June 30, 1914, the total value of the above mentioned articles exported was $118,900,590, the amount exported in the year ending June 30, 1915, was $324,545,357; while in the year ending June 30, 1916, they aggregated $933,632,000.

## EXPORTS OF INDIRECT MILITARY VALUE

War orders are variously defined and according to the definition the volume of such business will vary. If a narrow construction is applied, the term being used to include merely those articles which are used directly and unmistakably in military operations, their volume would be compassed within the above table. But an accurate construction of the term would involve the inclusion of a large number of articles which are not directly

employed in military operations. War involves the destruction not only of men but of a large amount of property which, in times of peace, would be used in gainful occupations. It involves the demoralization of labor forces, for the places of those taken to the front must be filled by inexperienced men, or in many cases remain vacant. Modern war has for its background a tremendous and Herculean business organization engaged in the production of food, clothing, ammunition, weapons and supplies of every character necessary to effective operations of armies numbering millions of men. Industries of every great belligerent have been largely remade. Factories which have produced cloth, for example, have been ripped out and converted into metal working shops. Other textile factories have, through changes in machinery and methods, been adapted to the production of uniforms, in which work special requirements must be met. Thus it follows that America has furnished not only an enormous quantity of goods directly useful in war, but she has been called upon to furnish a large amount of machinery and equipment of every kind which is necessary for the reconstruction of European industry or for substitution for goods which in peaceful times were produced by one or the other of the belligerents.

One of the most easily understood illustrations is foodstuffs. When France called millions of men to the colors, she depopulated her farms. It became necessary, therefore, to import a larger supply of foodstuffs than had theretofore been necessary. If we compare the exports of articles which are indirectly used in warfare, we will find that there has been an enormous expansion in this portion of the export business of the United States, which must be classified as a part of our war orders:

| Articles exported | Twelve months ending June 1914 | 1915 (value) | 1916 |
|---|---|---|---|
| Brass, articles made from | $3,966,645 | $12,819,373 | $128,331,820 |
| Breadstuffs | 165,302,385 | 573,823,676 | 435,696,629 |
| Copper and manufactures of (except ore) | 146,222,556 | 99,558,030 | 173,946,226 |
| Manufactures of cotton | 51,467,233 | 71,974,497 | 112,053,127 |
| Metal working machinery | 14,011,359* | 28,162,968* | 61,315,032* |
| Total iron and steel and manufactures of | 251,480,677 | 225,861,387 | 621,209,453 |
| Meat products | 143,261,846 | 205,785,468 | 266,795,608 |

| Articles exported | Twelve months ending June 1914 | 1915 (value) | 1916 |
|---|---|---|---|
| Zinc and manufactures of (except ore and dross).......... | $406,208 | $21,243,935 | $45,867,156 |
| Wool and manufactures of (including wearing apparel)..... | 4,790,087 | 27,327,451 | 53,983,655 |
| Cotton wearing apparel........ | 10,767,448* | 29,550,090* | 34,226,664* |
| | $766,897,637 | $1,238,393,817 | $1,838,324,012 |

* In footing the totals, duplications, indicated above by (*), have been avoided.

Combining the totals in the two preceding tables, we find that the volume of exports of those articles now directly or indirectly used in warfare had amounted to $885,798,227 in the year ending June 30, 1914. In the year ending June 30, 1915—the first year of war the total was $1,562,939,174 while in the year ending June 30, 1916 the total was $2,771,956,014. The increases in the amount thus exported in the last two years over the exports for the year ending June 30, 1914, is a rough measure of the war orders which America has filled:

| Year ending June 30 | |
|---|---|
| 1915.......................................... | $677,141,000 |
| 1916.......................................... | 1,886,158,000 |
| | $2,563,299,000 |

The increase in America's export trade has been almost entirely confined to the articles enumerated above. The value of all other classes of merchandise, not specifically enumerated above, exported from the United States in the two years of war, as compared with the year preceding the outbreak of the war, was as follows:

| Year ending June 30 | |
|---|---|
| 1914.......................................... | $1,443,885,798 |
| 1915.......................................... | 1,153,239,291 |
| 1916.......................................... | 1,500,441,760 |

Under ordinary conditions, the British blockade would have resulted in a material reduction in American export trade because it would have cut off Germany and her allies, numbered among our largest customers. As a matter of fact, the tremendous expansion of American trade is all the more remarkable because it

occurred in the face of the loss of the trade of the central powers. The comparative exports of all classes from the United States to the two groups of belligerents during the year preceding the outbreak of the struggle and the first two years of war are as follows:

VALUE OF EXPORTS OF MERCHANDISE

| | Twelve months ending June 1914 | 1915 | 1916 |
|---|---|---|---|
| *Central Powers:* | | | |
| Austria-Hungary | $22,718,258 | $1,238,669 | $152,929 |
| Bulgaria | 326,734 | 12,490 | 44,223 |
| Germany | 344,794,276 | 28,863,354 | 288,851 |
| Turkey | 3,328,519 | 994,120 | 42,169 |
| Totals | $371,167,787 | $31,108,633 | $528,172 |
| *The Allies:* | | | |
| Belgium | $61,219,894 | $20,662,315 | $21,844,638 |
| France | 159,818,924 | 369,397,170 | 630,672,504 |
| Italy | 74,235,012 | 184,819,688 | 270,489,922 |
| Russia | 31,303,149 | 60,827,531 | 313,515,364 |
| United Kingdom | 594,271,863 | 911,794,954 | 1,518,046,263 |
| Totals | $920,848,842 | $1,547,501,658 | $2,754,568,691 |

The Allies' blockade has practically isolated the Central Powers. Their exports have fallen to a negligible point. On the other hand, the purchases of the Allies from us have nearly trebled. The problem of financing war orders in America, therefore, relates almost entirely to the purchases of the Allies.

## INTERNATIONAL FINANCING BEFORE THE WAR

An understanding of the financial problems involved in paying for American war orders depends upon a comprehension of the general principles underlying the payment of debts between citizens of different countries. It is an axiom of business that international indebtedness, whether public or private, is settled almost entirely by the exchange of goods, giving rise to banking credits. Whatever balance there may be after these credits are exhausted is liquidated through the shipment of gold. The account of the United States with the rest of the world may be illustrated by reproducing the comparison made by Sir George Paish for our National Monetary Commission some years ago:

FOREIGN TRADE OF THE UNITED STATES, 1908–9

| | | | | |
|---|---|---|---|---|
| *Merchandise:* | | | | |
| Exports— | | | | |
| Domestic | $1,638,000,000 | | | |
| Foreign | 25,000,000 | | | |
| Total | | $1,663,000,000 | | |
| Imports | | 1,312,000,000 | | |
| Excess of merchandise exports over imports | | | $351,000,000 | |
| *Gold:* | | | | |
| Exports | | $92,000,000 | | |
| Imports | | 44,000,000 | | |
| Excess of gold exports over imports | | | $48,000,000 | |
| *Silver:* | | | | |
| Exports | | $56,000,000 | | |
| Imports | | 44,000,000 | | |
| Excess of silver exports over imports | | | $12,000,000 | |
| Total excess of merchandise, gold and silver exports over imports | | | | $411,000,000 |
| *Remittances for interest, etc.:* | | | | |
| Interest | | | $250,000,000 | |
| Tourist expenditures | | | 170,000,000 | |
| Remittances to friends | | | 150,000,000 | |
| Freight | | | 25,000,000 | |
| Total remittances | | | | 595,000,000 |
| Excess of sum remitted for interest, tourists, to friends, and for freight over trade balance | | | | $184,000,000 |

Sir George Paish estimated that the above balance of $184,000,000 was liquidated or settled by permanent or temporary investments made by citizens of other countries in the United States. A word of explanation concerning the above tabulation may be helpful. America, for a generation, has been exporting much more than she has imported, resulting in what is known as a "favorable balance of trade." This favorable balance of trade or excess of exports over imports, which in the year under consideration amounted to some $411,000,000, is eaten up through payments

which citizens of this country must make to foreigners for various purposes. The first item represents interest payments on foreign capital invested in this country, amounting to some $250,000,000. To this must be added the tourist expenditures of our citizens who, in peaceful times, went abroad for the summer. The excess of their expenditures over those of Europeans visiting this country was estimated at $170,000,000. The item "remittances to friends" represented assistance given by American immigrants to their relatives in the mother country. Inasmuch as most of America's oversea trade is handled in ships flying other flags, it follows that we must pay some $25,000,000 a year for freight.

The situation which Sir George Paish depicted in his comparison for the year 1908–09 is generally representative of the conditions which prevailed at the outbreak of the war. The trade balance of the United States, that is to say the excess of exports over imports, including not only merchandise but gold and silver, in succeeding years, was as follows:

| Year ending June 30 | |
|---|---|
| 1910 | $273,330,267 |
| 1911 | 489,809,443 |
| 1912 | 577,289,769 |
| 1913 | 691,790,307 |
| 1914 | 540,791,780 |

According to the best estimates, America's fixed charges payable to Europe, representing remittances for goods purchased, tourist expenditures, remittances from Americans to friends residing abroad, remittances for freight, insurance, etc., remained in the neighborhood of $600,000,000 per annum. This sum might be termed the United States' fixed charges which every year must be liquidated by an excess of merchandise exports over imports. When this excess has been less than $600,000,000, the deficiency has been made up through the exportation of gold from this country or the sale of additional American securities to European investors. When the balance of trade of the United States exceeds $600,000,000, Europe must either ship us gold or sell securities in our markets. As a matter of fact under normal conditions, as we have seen, the balance of trade corresponds very closely to what we have termed the fixed charges of the United States.

## CHANGES BROUGHT ABOUT BY THE WAR

With the advent of war orders, the situation was entirely revolutionized. The following comparison will show how abnormal became our trade relations with the rest of the world:

| Year ending June 30 | Merchandise exports | Merchandise imports | Excess of exports over imports |
|---|---|---|---|
| 1914 | $2,364,579,148 | $1,893,925,657 | $470,653,491 |
| 1915 | 2,768,589,340 | 1,674,169,740 | 1,094,419,600 |
| 1916 | 4,333,658,865 | 2,197,883,510 | 2,135,775,355 |

To settle this abnormal excess of exports over imports, totaling in the two years of war in the neighborhood of $2,300,000,000 (a sum roughly equal to the exportations of munitions of war), constitutes the financial problem of paying for American war orders. There are three methods by which a nation may settle an unfavorable balance in account with the rest of the world. The first is the exportation of gold, for gold is the international money of commerce. The second method is through the sale of securities in the markets of a creditor nation, the proceeds of which may be used to liquidate the balance of debt owing to that nation. The third method is to borrow a sum equal to the remaining indebtedness in the creditor country or in some other country from which the proceeds of the loan may be transferred to the creditor country to settle the indebtedness. All of these methods have been employed for many years. They have been used to an extent heretofore undreamed of in financing American war orders.

In view of the fact that Germany was cut off from America by the blockade, the problem of financing war orders concerns almost entirely the purchases of England for herself and her allies. It should be noted that at an early date England, by arrangement with her allies, assumed control of the matter of financing American purchases. Most of the financial operations have been carried on through the firm of J. P. Morgan & Company, acting as fiscal agents for the British government.

## THE PROCEDURE FOLLOWED IN WAR FINANCING

The procedure followed in financing American war orders can be divided into certain phases, each of which is more or less clearly defined, although in point of time overlapping. Immediately following the declaration of war, American bankers were embarrassed

by the necessity of providing gold for exportation to Europe in settlement of American debts. America for years had been in the habit of making short-time loans in foreign money markets during the spring and summer, to be repaid through the sale of cotton and other staples exported in the fall and early winter. It has been estimated that such borrowings were usually in the neighborhood of $400,000,000. Pressed as they were for funds, European bankers demanded repayment of these loans, while at the same time the uncertainty at the beginning of the struggle for command of the sea drove British and German ships alike to seek the safety of the most convenient harbors. Our foreign trade was paralyzed. Grain, cotton and freight of every character piled up at the seaboard and congested railway yards and terminals throughout the country. American bankers found themselves in the position of having loans to repay without being able to avail themselves of the proceeds of our customary export trade which would normally move at that season of the year. The only alternative which was open to them—for European and American stock exchanges were closed and hence the sale of securities could not be resorted to—was the exportation of gold. During the first few weeks following the outbreak of the war, gold moved to Europe in large quantities. The net loss to this country from August 1 to December 31, 1914, amounted to $81,720,000.

As a matter of fact, the outflow of gold was checked somewhat prior to the close of the year 1914. The reëstablishment of ocean communication and the lessening of the rigors of the British moratorium made available sufficient credits, shortly after the first of November, to enable American bankers to meet their obligations without the exportation of gold. Sterling exchange reached $4.86¾ on November 12, indicating practically normal conditions. In the meantime, Europe had been placing enormous war orders in America. The financial requirements necessary to meet these commitments and the realization that Europe's purchases of foodstuffs and raw materials would be greater than ever, led American bankers to believe that the worst was over, in so far as preserving a stable financial equilibrium was concerned. Accordingly, on November 28, 1914, the stock exchange was opened, with limitations upon trading designed to prevent wholesale liquidation at ruinous prices. These limitations were shortly thereafter removed.

## PURCHASES IN AMERICA AND THEIR EFFECTS

The enormous purchases of the Allies in America speedily turned the tables, so that instead of having to export gold and face a sterling exchange rate of $5, America was in a position where British exchange sold down to unheard of levels, touching the low point at $4.49 on September 4, 1915. An enormous importation of gold occurred. From surface indications one might have concluded that financial England was dangerously near a state of demoralization in handling the exchange problem. Apparently there were no adequate means of creating the necessary credits in America. In the absence of any authentic explanation, various reasons have been given for England's apparent lack of policy controlling the exchange markets. One explanation which has been offered is that England over-estimated the extent of the liquidation in the New York market by foreigners of American securities owned by them. As a matter of fact, whatever may be the real reason, the fact remains that the inflow of gold continued in very large quantities, reducing the reserve at the Bank of England to a point which in peace times would have been considered dangerous. It was evident that the Allies must devise other methods to finance their American purchases.

It should be added parenthetically that the importation of gold has continued at irregular intervals throughout the entire period since the outbreak of the war. Gold has moved to this country whenever other methods of financing American purchases have been insufficient, and it is reasonable to suppose that we have not yet reached the end of such gold importations. The record of gold imports and exports, together with the net loss or gain throughout the period of war compares as follows:

GOLD IMPORTS AND EXPORTS

*(000 Omitted)*

| Time | Exports | Imports | Net movement + or − |
|---|---|---|---|
| Aug. 1914 to Dec. 31, 1914..... | $104,973 | $23,253 | $−81,720 |
| Jan. 1, 1915 to July 2, 1915 .... | 6,266 | 146,960 | +140,694 |
| Jul. 2, 1915 to Dec. 31, 1915.... | 24,727 | 304,995 | +280,268 |
| Jan. 1, 1916 to June 30, 1916... | 67,291 | 190,149 | +122,858 |
| Net increase........................................... | | | $462,100 |

The net addition to the gold stock of the United States from the outbreak of the war to June 30, 1916, was $462,100,000.

In point of aggregate amount, the shipment of gold to the United States in settlement for war purchases was the least important method employed. By far the larger part of the tremendous balance which the allied nations owed us has been paid through the sale of securities in American markets, creating credits which could be utilized in payment of these enormous debts. The securities sold in this market consisted of two classes: (1) the sale of government bonds and other obligations created by the belligerent nations to finance the war; and (2) the re-sale in America of European holdings of our securities.

## FLOTATION OF FOREIGN GOVERNMENT LOANS

The flotation of foreign government loans in America has been accomplished under conditions not altogether favorable. American investors have a natural prejudice against putting their money into projects located at a distance. The average bond buyer prefers the security of a corporation situated near his home to one conducting business in a distant part of the country. When he is asked to put his money into some enterprise in a foreign land, he has shown little enthusiasm for the project. It was, therefore, a rather difficult matter to make a market for large amounts of European government securities. During the period when large gold shipments were being made to America, European bankers had effected short-time credits with American financial institutions. As the maturity of these short-time loans approached, it became imperative that they should be funded by some more permanent method of financing. J. P. Morgan & Company, as the fiscal agents of the Allies, after extended negotiations, formed a syndicate which floated $500,000,000 of bonds representing the joint obligations of the English and French governments, bearing 5 per cent interest and maturing within five years. These bonds were offered at 98. Looked at from a strictly technical viewpoint, the loan was only moderately successful. The bonds have never sold up to the issuing price. A great deal of hard work was necessary to get the investing public to absorb them. However, in view of the unfamiliarity of American investors with foreign loans and the prejudices which existed, the success of the loan was probably as good as could be expected.

The Anglo-French loan was followed by the sale of a number of smaller issues and the creation of short-time credits. The *New York Journal of Commerce* has prepared the following summary of the foreign loans effected in America from the outbreak of the war to June 30, 1916:

EUROPEAN LOANS NEGOTIATED IN THE UNITED STATES

*August 1, 1914 to June 30, 1916*

| | |
|---|---|
| Anglo-French governments 5 % 5-year bonds | $500,000,000 |
| British banking credit for six months at 4½ %, renewed for 12 months at 5 % | 50,000,000 |
| French government: | |
| Treasury notes, 5 % one year (paid) | 10,000,000 |
| Treasury bonds, 5 %, one year (paid) | 30,000,000 |
| Commercial credit | 20,000,000 |
| Collateral loans made through Rothschild's and secured by Penna. R. R. and St. Paul R. R. bonds (paid) | 30,000,000 |
| Acceptance credit for one year | 15,000,000 |
| Additional acceptance credit | 15,000,000 |
| Russian government: | |
| Credit, 6½ %, 3 years | 50,000,000 |
| Acceptances (paid) | 25,000,000 |
| Credit to Russian-Asiatic bank | 25,000,000 |
| Treasury notes 5 %, one year (paid) | 10,000,000 |
| Banking credits, private arrangements | 7,000,000 |
| Italian government bonds, 6 %, 1 year | 25,000,000 |
| German government: | |
| Notes, 5 per cent, 9 months (paid) | 10,000,000 |
| Notes (6 % basis) due April, 1917 | 10,000,000 |
| Banking credit (estimated) | 6,000,000 |
| Swiss government, notes 5 %, 1, 3 and 5 years | 15,000,000 |
| Greek government, loans negotiated with banks | 7,000,000 |
| Swedish government, notes, 6 %, 2 years | 5,000,000 |
| Norwegian government: | |
| Bonds, 6 %, 7 years | 5,000,000 |
| Notes, 6 %, 2 and 3 years | 3,000,000 |
| Miscellaneous loans and banking credits (estimated) | 27,000,000 |
| Total | $900,000,000 |

The aggregate face value of the loans negotiated in America (presuming that the statement of the *Journal of Commerce* includes all of the loans negotiated) is $900,000,000. If we add to this total the excess of gold importations in America over exportations from this country of $462,100,000, we have a total of $1,362,100,000.

Comparing this with the abnormal trade balance of $2,500,000,000, representing Europe's war bill due this country, we see that there remains to be financed payments aggregating some $1,200,000,000. Unless there had remained to the Allies some other method of effecting such payments, they would of necessity have been compelled to restrict their war purchases to the total sum indicated.

## European Holdings of American Securities

The greatest resource which the allied nations possessed in meeting their bills was their ability to sell American securities, held by their citizens, in our markets, thereby creating credit balances which could be used in the settlement of debts owing to us. The extent of European holdings in American securities has been the subject of much speculation. The most authoritative statement which we possess is that prepared by Sir George Paish for our National Monetary Commission in 1910:

Great Britain possesses about $3,500,000,000 of American securities. To this sum has to be added the considerable amounts invested by the continent. Large amounts of German, Dutch, and French capital are embarked in American undertakings, principally railways. A statement drawn up in 1902 at the instance of the French Minister of Finance from reports supplied by French diplomatic agents and consuls in various parts of the world placed the total amount of French capital invested at that time in the United States at 600,000,000 francs, or $120,000,000, but this figure appears to have been an underestimate. It is true that few issues of American securities are publicly quoted on the Paris Bourse, but relatively large amounts have been purchased privately by French investors in London and in New York. The French investments in the United States, including the Pennsylvania Railroad and other loans placed in Paris since 1902, amount to nearly 2,500,000 francs, or $500,000,000.

Estimates of the amount of capital invested by Germany in the United States were made in 1905 by the German Admiralty and published in a work entitled *Die Entwicklung der Deutschen Seeinteressen im letzten Jarhzehnt.* These estimates placed the amount of German capital in the United States and Canada in 1904 at from 2,500,000,000 marks to 3,000,000,000 marks, say, $625,000,000 to $750,000,000. Since 1904, considerable additional sums of German capital have been invested in the United States. German bankers place the amount of the German investments in American securities at about $1,000,000,000. The amount of Dutch capital in the United States is about $750,000,000. American securities are also held in Belgium, Switzerland, and in other countries. In the aggregate the amount of European capital invested in "permanent" securities in the United States is approximately $6,000,000,000.

It is generally believed that no great change occurred in the volume of European investments in America from the date of this estimate to the outbreak of the European war. What proportion of these investments can be re-sold is a matter concerning which no definite information is at hand. A very considerable proportion of the total is represented by the ownership of land, small manufacturing enterprises and unlisted securities for which no ready market exists and which therefore must be disposed of slowly and by individual bargain. The most readily available portion of European holdings consists of American railroad stocks and bonds and of the securities of certain great industrials listed on the stock exchange and for which an active market ordinarily exists. No authoritative computation has been made of the extent of such industrial investments.

The only data which we have concerning the extent of European liquidation relate to the holdings of railroad securities. Mr. L. F. Loree, President of the Delaware and Hudson Company, has made three inquiries since the outbreak of the war of some 144 railroads—being all of the roads in the United States over 100 miles in length—as to the amount of their securities standing in the names of foreign owners. The results of his three inquiries are as follows:

American Railroad Securities Held Abroad

| *Class of security* | *Jan. 31, 1915* | *July 31, 1915* (Par value) | *July 31, 1916* |
|---|---|---|---|
| Preferred stock | $204,394,400 | $163,129,850 | $120,597,750 |
| Second preferred stock | 5,558,150 | 5,608,850 | 4,858,650 |
| Common stock | 573,880,393 | 511,437,356 | 336,761,704 |
| Notes | 58,254,390 | 24,632,292 | 9,070,955 |
| Debenture bonds | 187,508,310 | 160,288,700 | 74,796,900 |
| Collateral trust bonds | 282,418,415 | 180,590,850 | 85,166,470 |
| Mortgage bonds | 1,371,156,851 | 1,150,339,130 | 774,793,834 |
| Equipment trust bonds | 20,233,455 | 25,253,201 | 7,788,300 |
| Car trusts | .......... | 29,000 | 836,000 |
| Receivers' certificates | 998,000 | 2,201,000 | 958,000 |
| Total | $2,704,402,364 | $2,223,510,229 | $1,415,628,563 |

A perusal of the above table indicates the extent to which Europe has sold her American securities in order to finance her extraordinary purchases in this country. It should be noted that

this comparison only partially reveals the extent of European liquidation. It deals only with bonds and stocks in the names of foreign holders. It does not cover the sale of foreign owned securities which have stood in the names of American bankers, brokers, or institutions and which are generally believed to aggregate an enormous total, nor does it take into consideration the sale of listed industrial securities or of securities issued by small industrial concerns. Without considering the additions which would be represented by these unknown elements, the total is nevertheless staggering:

REDUCTION IN HOLDINGS

| *Reduction:* | *In par value* | *In market value* |
|---|---|---|
| Jan. 31, 1915 to July 31, 1915 .... | $480,892,135 | Not stated |
| July 31, 1915, to July 31, 1916.... | 807,881,666 | $641,338,822 |
| Total...................... | $1,288,773,801 | ? |

Presuming for the moment that foreign holders receive, on the average, par for securities sold, which is unlikely, and adding the total par value of the railroad securities disposed of to the face value of government bonds sold in this country and to our net importations of gold, we find that we have accounted for the $2,500,000,000 of abnormal purchases arising out of the war:

| | |
|---|---|
| Net import of gold.............................. | $462,000,000 |
| Foreign government and bank loans made in America | 900,000,000 |
| European securities resold in America............. | 1,288,773,000 |
| | $2,650,873,000 |

## MOBILIZING THESE SECURITIES

As a matter of fact, the mad rush of war expenditures in America exceeded the rate of liquidation of foreign-owned American securities. In spite of the necessities of European business men who must deplete their strong boxes in order to liquidate the losses and repair the crippling effects of war, in spite of the forced sales of American investments by foreign families left without sufficient income while their bread-winners were at the front, and the sale of securities by widows and orphans in closing estates or financing their needs, the stream of liquidation must needs be quickened by governmental pressure. With the American market displaying unmistakable signs of a limited capacity for European governmental

loans, and faced with the prospect of undermining foreign banking systems through continued withdrawals of gold, the allied nations were forced to use pressure to accelerate the disposal of American securities owned by their citizens. Out of this necessity was born the British mobilization plan in January, 1916. The plan in brief provided for the mobilization, or concentration in the hands of the British government, of American securities owned by its subjects. The holders of such securities are given several options. The first option provides for the sale of American securities to the British government, payment being made in British exchequer bonds at specific prices fixed from time to time by the government. The second option makes provision for holders of American securities who, for any reason, are not prepared to sell them. From such the British Treasury is willing to accept the securities on deposit subject to a right of purchase on certain contingencies. The government in effect borrows the securities for a period of two years. While on deposit, the lender of the securities is to receive the interest and dividends paid in respect to them, and also, by way of consideration for the loan, a payment at the rate of ½ or 1 per cent per annum, calculated on the face value of the securities.

The securities acquired through the British mobilization plan can be used for two purposes: first, to sell in the American market in order to build up banking credits. Doubtless many securities have been so used. Such sales have been made quietly and unobtrusively, and it is impossible to measure their extent. Second, American securities thus acquired are pledged for loans in America, made either by banking institutions or through the flotation of bonds and notes by investment bankers. Numerous short-time credits with American bankers have been made by foreign banks or governments using such securities as collateral.

### OTHER RECENT DEVICES

Of late, subsequent to the period covered by our inquiry, England and France have taken to financing themselves on an extensive scale through the aid of these securities. The French plan is the creation of an American corporation known as the American Foreign Securities Company, which has issued a collateral loan of $100,000,-000, represented by 5 per cent three-year gold notes of the corpora-

tion secured by the pledge of $120,000,000 of securities made up as follows:

APPROXIMATE VALUE AT PREVAILING PRICES AND THEN EXISTING EXCHANGE RATES

| | |
|---|---|
| Government of Argentina | $20,500,000 |
| Government of Sweden | 8,725,000 |
| Government of Norway | 3,290,000 |
| Government of Denmark | 6,380,000 |
| Government of Switzerland | 12,080,000 |
| Government of Holland | 1,475,000 |
| Government of Uruguay | 3,443,000 |
| Government of Egypt | 20,200,000 |
| Government of Brazil (Funding Loan) | 1,181,000 |
| Government of Spain | 12,600,000 |
| Government of Spain guaranteed railroad bonds | 8,000,000 |
| Province of Quebec | 275,000 |
| Suez Canal Co. shares | 11,600,000 |
| American corporate issues | 3,700,000 |
| | $113,449,000 |

The British government in August, through a syndicate headed by J. P. Morgan & Company, floated a $250,000,000 5 per cent two-year loan representing the direct obligation of the British government and further secured by the deposit of $300,000,000 of collateral to be made up as follows:

| | |
|---|---|
| Group 1, Stocks, bonds and other securities of American corporations of the aggregate value of not less than | $100,000,000 |
| Group 2, Bonds or other obligations of the Government of the Dominion of Canada, either as maker or guarantor, and stocks, bonds and other securities of the Canadian Pacific Railway Co., of the aggregate value of not less than | 100,000,000 |
| Group 3, Bonds or other obligations of the several following governments, either as maker or guarantor, to wit: of Argentina, Chile, Norway, Sweden, Switzerland, Denmark and Holland, of the aggregate value of not less than | 100,000,000 |

Two significant tendencies are to be noted in these loans: first, the constantly more favorable basis as regards price and interest rate at which succeeding financing is done. This tendency will doubtless continue in future financing. Second, the recognition by the foreign governments of the necessity of pledging collateral in order to attract American investors—a distinct departure in methods of

war financing. It is important to note that a large proportion of the collateral pledged is itself not readily salable in American markets. There is no American market, generally speaking, for the bonds of Chile, Norway, Sweden, Denmark or Holland. It would be even more difficult to sell advantageously in American markets the securities issued by the governments of Uruguay, Egypt or Spain.

By pledging this collateral, however, with a sweetening of from 3 per cent to 33⅓ per cent of American securities, England and her allies are postponing the day when they will be face to face with the exhaustion of this most precious method of financing war purchases. England is jealously husbanding her American collateral. She is paying it out as a miser might do, foreseeing that she must finance war purchases from us for a long period of time. The sale of loans secured by collateral, which in itself would be unsalable, postpones the day of exhaustion of her supply of standard securities which might thus be sold. It requires no mathematician to see that if the liquidation of American securities by Europe continues at the rate heretofore prevailing, these resources will be exhausted before January 1, 1918. The happening of this contingency prior to the termination of the war opens up a financial problem the contemplation of which is not pleasant to English bankers.

America is rapidly getting out of debt. It would have required generations for us to have accomplished what is occurring in a few brief months. We are like a family who, through fortuitous circumstances, is enabled to pay off the mortgage on a house. It will soon be unnecessary for us to send abroad merchandise and commodities of various kinds, exceeding our purchases by some $250,000,000 per annum, in order to pay the interest upon our indebtedness. The effect of this situation upon our future international trade does not fall within the scope of this discussion. It should be pointed out that England has been undermining at an appalling rate her tremendous financial strength. As Mr. Francis Hirst, for many years editor of the *London Economist* and one of the leading financial authorities of England, has pointed out, it is doubtful whether, in the long run, England would have gained had she been unable to effect such enormous war purchases in America. Mr. Hirst advances the opinion that England has done Germany a real service by blockading her. She has forced the Teutonic allies to be self-sufficient; to go in debt to themselves rather than to foreign nations to produce

the materials of war. History will demonstrate whether this view is correct.

### THE SIGNIFICANCE OF WHAT HAS OCCURRED

The significance of the liquidation of England's holdings of American securities can be briefly stated. England and her allies cease to have the right to share in the productive capacity of America. As the holder of mortgage bonds, entitled to a fixed rate of return, or a prior share in the profits of American production, and as the owners of stock in American corporations, they have enjoyed for years the right to draw upon this country for a large share of our annual production. These earnings have been in part reinvested, so that for many years the amount of goods which had to be exported to European owners and creditors steadily increased. Today European investors have exchanged the right to a large share of the production of America for the promises of their own governments to pay principal and interest. Instead of receiving countless shiploads of grain, cotton, meat and manufactured articles in payment of interest upon these investments, the annual returns must be raised by taxation of themselves. Looked at from the broadest economic viewpoint, England and her allies are shooting away, upon the fields of France and Belgium, their claim to an imperial share in the railroads, steel mills and other productive plants of the western world.

# FOREIGN EXCHANGE DURING THE WAR

By George Zimmer,

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One of the many difficult problems facing the belligerent nations in Europe during the past two years, certainly the most far-reaching one as far as the foreign commerce of the allied nations —England especially—is concerned, has been the supporting of the foreign exchange rate as near as possible to par, and if this was impracticable, at least near a certain level.

## Conditions at the Beginning of the War

In order to fully appreciate the importance of this consequence of an economic disturbance, which compelled the whole financial world to face new and untried conditions, it is necessary to go back to the beginning of the war. When, in the latter part of July, a settlement of Austrian demands on Servia proved futile and the spectre of a huge world war loomed threateningly on the European horizon, its influence was immediately reflected in the foreign exchange situation. It was a commonly known fact that America, at the outbreak of the war, was a debtor to Europe of about $450,000,000. The city of New York, alone, owed $80,000,000 in London and Paris which matured during the most critical period. Past experience has shown that our grain and cotton shipments in the fall largely offset such balances as may have been created against us during the summer months. The sudden withdrawal, however, of most ocean going vessels made the shipping situation so acute that some of the railroads had to put an embargo on export shipments; this, of course, was followed by a dearth of commercial bills in the market and caused a violent upward movement in demand sterling, which on July 21 stood at 4.8725, practically normal for that time of year. It rose by leaps and bounds in an unprecedented manner until on August 3 quotations of $6.00 and $7.00 per pound were not infrequent. Marks had risen to $1.04 and francs were almost unobtainable, fcs. 3.25 being asked for on a dollar.

This unexpected phenomenal rise naturally worked great hardship on the importer, who had to pay for his bills from his English and Continental friends at an exorbitant rate, while it proved a boon to the exporter who secured, at times, 50 per cent over and above his merchandise profit by selling his exchange in the open market. This situation became so chaotic, especially in view of the large settlements which had to be made at that time, that the prominent banks in New York got together and fixed an arbitrary rate of $5.00 for sterling and $1.00 for five francs and four marks. This arrangement, of course, was only temporary and could not prove an effective means for the support of American exchange in London. After some preliminary conferences, a committee was appointed by the leading banks and trust companies, consisting of prominent foreign exchange men and bankers, to discuss relief, which finally led to the establishment of a $100,000,000 gold fund, to which a number of prominent national banks, state banks and trust companies contributed a part. This gold fund was to be considered part of the Bank of England gold reserve and was to eliminate the hazard of gold shipments abroad; insurance premium on gold coin or bars at times being quoted at between two and three per cent. A subsequent arrangement between bankers on this side and the British government provided that deposits of gold could be made with the depositors of the Bank of England in Ottawa, the Canadian Minister of Finance, the equivalent of which at 4.90 would be made available in the depositor's London account immediately.

### The Effect of the Gold Pool

It may readily be seen what an effect these measures had on the course of the foreign exchange rates. They imparted a feeling of security to the market, for the banker could at least rest assured that he could obtain the exchange at a reasonable figure by shipping gold without risk, providing always the latter could be obtained, which was very doubtful at times. This measure, however, coupled with the increasing exports of foodstuffs and cotton, made possible by the prompt measures taken by the United States Treasury Department in creating a war risk insurance bureau, soon brought exchange back to the normal level.

The end of 1914 saw exchange on London and Paris at practically normal, rates being quoted at 4.85½ and 5.16 respectively.

The rate on Germany, however, was quoted at 88¾, being a discount of about 8 per cent from par. This can, of course, be readily explained by the difficulty experienced by Germany in paying her debts in merchandise, due to the inability of her merchant marine to resume activities in face of the allied blockade, which proved one of the main factors of the downward trend of German exchange. The central empires, in this connection, are in about the same position as Russia whose foreign trade had practically ceased after the closing of the Dardenelles, and who, in order to establish at least a somewhat stable basis for exchange, had to resort to the two other alternatives—shipment of gold and raising of loans. These remedies, however, were largely offset by the tremendous importations of war materials into Russia, which by providing a continuous flow of exchange, had a very depressing influence on the market.

### THE PHENOMENAL GROWTH IN OUR EXPORTS

While up to the period just mentioned, the bankers of this country had to exert their power in order to prevent American exchange from declining in London, the new year saw spectacular changes in the foreign financial situation of this country. Coupled with the large shipments mentioned above, the demand for war materials kept the exports of this country at a high mark, while imports were considerably less than in the same period during the previous year, which may be seen from the following figures:

EXPORTS FROM U. S. A.

| | *1915* | *1914* |
|---|---|---|
| January | 267,900,000 | 204,067,000 |
| February | 299,800,000 | 173,920,000 |
| March | 296,600,000 | 187,499,000 |
| April | 294,700,000 | 162,600,000 |
| May | 274,200,000 | 161,700,000 |
| June | 268,600,000 | 157,100,000 |

IMPORTS INTO U. S. A.

| | *1915* | *1914* |
|---|---|---|
| January | 122,148,000 | 154,743,000 |
| February | 125,123,000 | 148,045,000 |
| March | 158,040,000 | 182,555,000 |
| April | 160,600,000 | 173,800,000 |
| May | 142,300,000 | 164,300,000 |
| June | 157,700,000 | 157,500,000 |

EXCESS EXPORTS OVER IMPORTS

| | *1915* | *1914* | |
|---|---|---|---|
| January | 145,700,000 | 49,324,000 | |
| February | 174,600,000 | 28,875,000 | |
| March | 136,000,000 | 4,944,000 | |
| April | 134,170,000 | 11,209,000 | x Imports |
| May | 131,933,000 | 2,549,000 | x " |
| June | 110,856,000 | 457,000 | x " |

It can readily be seen from the above figures, that while in normal years the balance of trade in favor of the United States kept dwindling down during the first six months of the year, with a necessary stiffening of rates on Europe, the enormous imports of England, due to her added requirements on account of the war, built up a balance in favor of America which her diminishing exports could not overcome. It must, however, be said that in spite of this handicap the exchange rates on London were very steady. It must be remembered that the usual summer exodus of American tourists to Europe could not take place on account of the war. It is estimated that expenditures of Americans abroad during a year amounted, as a rule, to over $300,000,000, most of which was settled through London banks, and this sum always contributed very largely towards offsetting an unfavorable balance of trade. England, and London especially, has always been the center of the foreign exchange market, exchange on the Continent being largely dealt in there, and it proved its sustaining influence even in these troubled times. Both sterling and francs maintained their position exceedingly well, but Italian lires declined very rapidly, being quoted at 5.46½ on February 1 and declining precipitately to 5.90 on March 1. In the second half of February sterling and francs, being unsupported, began to decline to 4.80 and 5.28 respectively.

No further adverse development took place in the market until the latter part of May when francs suddenly developed a pronounced weakness. Sterling began its downward course in the latter part of June and was quoted at 4.74, a discount of about 2 per cent. It continued at about that level until the beginning of August, when a very panicky drop took place, which carried sterling to the lowest point it ever sold at, 4.48½, showing a discount of about 8 per cent. This fall was mainly attributed to the fact that some houses in London, who had been largely interested in the importa-

tion of war material and commodities for the month of September, were trying to cover their forward commitments; when the enormous sums to be settled for in New York became known, the rates gave away completely. The decline in exchange, however, was only temporary as almost every one owning American securities sought to take advantage of the premium in London on New York exchange, amounting to about 7 per cent, and several millions of dollars of these were thrown on the market. This naturally had a rallying effect on the rates, which in the next few days rose again to 4.71, or a discount of 3¼ per cent.

### Conditions Precedent to the Anglo-French Loan

This very disastrous fluctuaton in sterling rates brought home to the British bankers the necessity of not only a more widely enforced policy of economy, but also the need of an adequate machinery which would act as a steadying factor in the foreign exchanges. There is no doubt that the rumor of an Anglo-French loan, which appeared in the market at that time, contributed very largely towards the sudden upward movement of sterling; before its realization, however, the selling of American securities in the financial centers of the Entente Allies continued, and large amounts found their way back to the United States. The selling, to a certain extent, came from English holders who wished to subscribe to the second British war loan, which was issued at that time. It must also be mentioned that at that time the French bankers entered the field as borrowers for the purpose of strengthening their exchange rate, which had fallen to 6.10. The so-called Rothschild loan, based upon a pledge of Pennsylvania 3¾ per cent and St. Paul Railway bonds netted $43,000,000. The loan, floated by Brown Brothers & Co., based on collateral in the form of acceptances of Paris bankers, produced $25,000,000; these sums were sufficient to steady francs, temporarily at least. They rallied to 5.79.

It must be borne in mind that not only the warring nations, but also the United States, were vitally interested in the plan to keep the rates at a certain level, and it was with this idea in mind that the English and French Commission arrived in New York in September, 1915. A credit had to be negotiated, for a moderate premium of 2 or 3 per cent would not, in the long run, induce the English investors to part with their American securities, and it was

at that time certain that few realized the need for selling from patriotic motives. The now famous Anglo-French loan of $500,000,000 was negotiated on September 28, 1915. The plan contemplated the issue of $500,000,000 five year 5 per cent bonds, which were a direct obligation of the British and French governments. These bonds were repayable at the end of five years, or convertible at the option of the holder into 4½ per cent bonds of the two governments, repayable not earlier than fifteen and not later than twenty-five years, by both governments. The bonds which the underwriters received at 96, were dealt out to the public at 98, yielding about 5½ per cent. A special clause stipulated that the proceeds were to be used exclusively for purchases in the United States. It provided sufficient funds to keep sterling at around 4.76 $^7/_{16}$ and francs at an average of 5.90 for the next three and a half months. Contributions were to be paid in instalments as needed, the first payment being made on November 13; by the end of November 45 per cent, or almost half, had been paid to the National City Bank of New York as central depository; by January 3, three-quarters of the entire loan had been called for; the last payment was made on March 4, when the remaining 15 per cent were drawn against.

It is, of course, clear that this enormous amount of available funds gave to the market a steadiness it had not enjoyed since the beginning of hostilities. Instead of drawing on the purchaser of American goods in London or Paris, and selling his bill in the market, the exporters could go to New York where, after being viséd by the representatives of the respective governments, his claim was promptly paid in United States dollars. This took an enormous amount of exchange out of the market, which factor was the main reason for the steadiness of sterling exchange, which in fact, as already mentioned, remained at around 4.76 $^7/_{16}$ for about three months.

## Mobilizing Securities to Support Exchange

It must, however, not be supposed that France and England remained idle during that period. Arrangements were made by England in December, 1915, under which a credit of $50,000,000 was granted by a syndicate of American bankers, to a group of eight leading joint stock banks, for the facilitating of private transactions. This credit was secured by a deposit of British government

securities and was availed of in the form of acceptances bearing 4½ per cent interest, and running six months. This provided payment for about $50,000,000 of American exports, and contributed largely to keeping the market at the above mentioned level. Efforts were made as early as the summer of 1915, to mobilize the holding of French and English investors in American securities, in order to prepare for the eventual secured loan, which later events showed was inevitable if the allied governments wished to secure financial help in the United States, or have securities in hand which might be used as an immediate remedy should a fall in exchange become inevitable. The British government, after various appeals to the patriotism of its people, resorted to taxation as a means of compelling English investors to dispose of their securities. A special tax of two shillings per pound sterling was levied on all securities which were included in the mobilization plan, which meant an extra tax of 10 per cent. It may be said that even this tax did not induce all the large investors to part with their American securities, and considerable amounts are, undoubtedly, held in Europe. The purpose of the measure was to create an eventual offset to the enormous imports of the Entente nations in the above stated manner. The French government followed the example of her ally and made a special appeal to the patriotism of her citizens to lend it their foreign securities for one year, with an option of the government to retain them from year to year for three years. Negotiable receipts were given in exchange, dividends were paid as usual and a bonus of ¼ of per cent of the regular income was given, or, to illustrate, a 5 per cent bond would bring a return of 6¼ per cent.

### THE LARGE IMPORTATIONS OF GOLD

When the proceeds of the Anglo-French loan were used up in payment for exports from this country, a temporary resort was had to selling of American securities. For the evident reason that a selling by private holders of American securities in the open market to America would have the very much desired effect of steadying the exchange situation, no obstacle was put in the way of such liquidation and it seemed rather to receive the full sanction of the government. The amounts realized from such sales, together with gold shipments of, however, no abnormal size, and the very ready ability of the agents of the British government to come to the sup-

port of the market, helped exchange over the critical period when deposits on the Anglo-French loan began to ebb in April of this year. A very interesting story may be learned by comparing the gold imports into the states during the first seven months of 1916.

| *1916* | *Millions of Dollars* |
|---|---|
| January | 15.080 |
| February | 6.016 |
| March | 9.776 |
| April | 6.121 |
| May | 17.321 |
| June | 122.734 |
| July | 62.107 |

It will be seen from these figures that, while funds were still available from the loan, gold imports were practically insignificant; when, however, other remedies were imperative for the steadying of exchange a sudden increase in gold importations took place, jumping from six millions in April to twenty-seven millions in May. In June the record-breaking gold imports contributed largely toward keeping the rates at the desired level, and in July, while not nearly reaching the dimensions of June, the imports of the precious metal were large enough to support the market. There is also no doubt that the rumors about a new fully secured loan to be floated in August for both the French and British governments had a reassuring effect on the market. These rumors developed into actuality when on August 1 the American Foreign Securities Company was organized with a capital $100,000,000 paid in full. It was arranged with the government of the French republic to lend them the sum of $100,000,000, for which it was to hold the obligation of the French government to repay the principal in three years, together with interest more than sufficient to cover the company's note issue. This loan is so far very interesting as it is the first officially sanctioned government loan for which the French republic had to put up collateral, and which netted them only $94,500,000 in actual cash. The collateral used for this loan was collected under the mobilization scheme and consisted almost entirely of government securities of neutral countries, of about $11,600,000 Suez Canal Company's shares and about $4,700,000 American securities. An English loan of $250,000,000 followed shortly afterwards, to bear 5 per cent and

running two years, also fully secured and offered by J. P. Morgan & Co., as syndicate managers. The list of securities which was made public is divided into three classes each aggregating $100,000,000, the first consisting of American railroad, industrial and municipal securities, the second of bonds of the Dominion of Canada and the third of government bonds of neutral countries. These loans served the same purpose as all the others, and to such an extent has the American foreign exchange man become accustomed to the idea that the allied governments—unforeseen disasters excepted—will be able to keep up the rates, that the announcements of these relief measures hardly cause a ripple on the market.

### Other Expedients Employed

While in the foregoing we have reviewed the principal measures of the Entente nations to support their exchanges by exports and creation of credits, the very urgent appeal for economy, made finally in the form of embargoes on certain articles, both for import and export, should not remain unmentioned. The exportation of such articles was, of course, prohibited from national motives, but the embargoes on imports had certainly a rallying influence on the exchange as they lessened the supply of commercial bills in the market.

It may be mentioned, in connection with the above, that Russia and Italy, the other large economic factors on the Entente side, employed the same means as their Allies for the steadying of their exchange; their loans, however, mostly took the form of bank loans except the $50,000,000 loan recently raised here by Russia, which embodies some very remarkable features, especially designed to assure the investor of a part in the profits which may be realized from a rise in rouble exchange.

Reports have been published here, that some of the most powerful German joint stock banks, aided by the Reichsbank, had endeavored in the beginning of this year to control the exchange market by fixing the buying and selling rate of marks each day and arranging that all bills sold were to be closely scrutinized, in order to prevent speculation. While such a measure might, with the necessary financial backing, steady the rate of exchange, it may be considered as useless and fallacious for the purpose of raising the rate at a time when payments in gold cannot be used in settlement

of foreign debts and when the export of merchandise is practically crippled. There is no doubt that the financial leaders of the great German banking institutions were fully aware of this.

In looking back over the financial history of the last two years, the main and the only measures which were taken by the various governments, may be summed up in three classes: shipping gold, selling foreign securities and paying debts with credit. How long this *modus operandi* can continue is a matter of conjecture. A pyramid of credit must have a sound foundation and, while there is little doubt that the British government will be able to finance her own and her Allies' purchases, signs are not wanting that credits to be secured for such purposes will find the neutral investor more and more exacting as time goes on and as the wealth destroyed in the present unprecedented struggle grows to gigantic proportions. The history of the loans to be raised from now until the end of the war for the purpose of steadying exchange, while not creating new problems will, without doubt, present some very interesting features.

# NEEDS FOR CAPITAL IN LATIN AMERICA: A SYMPOSIUM

## Introduction

By William H. Lough,

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For a period of years prior to 1912–13 the east coast of South America was liberally financed by England, France, Belgium and Germany, with some contributions of capital from other countries. There is a question, indeed, as to whether this European financing was not over-liberal. There are numerous instances in Brazil and Argentina of costly public buildings, beautiful parkways and avenues, railroad lines extending into undeveloped country, and other memorials of the expenditure of capital far beyond the commercial needs of the territory. Commercial and financial rivalry between the European nations placed the borrowing countries during these years in an especially advantageous position. The tightening financial market of 1912–14 reduced the free outflow of European capital; and the outbreak of the war suddenly cut it off altogether.

The results were naturally unpleasant. Brazil was unable to maintain her stock of gold and Brazilian currency became inconvertible and unstable. The Brazil railways, as well as other important enterprises, found the burden of paying interest (due in gold) with a depreciated currency more than could be sustained and went into bankruptcy. In Argentina and Uruguay there was a serious panic.

Other sections of South and Central America have not been so much favored by investments of European capital. For this very reason, they suffered less of a shock at the outbreak of the European war. However, the foreign commerce of practically all of them has been more or less dislocated; consequently, governmental revenues have been greatly reduced and the exchange values of their currencies have fallen. This has not been the universal experience, but it is typical of the situation in most of these countries.

Throughout South and Central America, merchants, bankers, organizers of transportation and other enterprises and governmental officials have all alike turned hopefully to the United States as a

possible source of capital to tide over the difficulties occasioned by the war. Nor have they looked wholly in vain. The governments of Argentina, Uruguay and Chile have secured substantial loans. Some large mining and other developmental enterprises have been in whole or in part financed. Yet, on the whole, the result has been disappointing and there have even been traces of some bitterness of feeling against the bankers and investors of this country.

There is probably little sound reason for this feeling. Apart from the undeniable ignorance and indifference of American investors in relation to foreign securities, the European cataclysm has brought with it uncertainties in all lines of business and has made investors more than usually chary of committing themselves through the purchase of long-period obligations. It has seemed to the writer, at times, that in some of the more isolated countries the wide-reaching influence of the war on financial affairs is not fully appreciated. It is not reasonable to expect that capital will flow from this country into South and Central American countries except under one of two conditions: either the investment must be for a short period and secured beyond all probable question; or some exceptional inducement must be offered.

The chief capital requirements of South and Central American countries may be grouped under these heads:

1. Loans to governments to enable them to meet current expenses;
2. Loans to municipalities to be expended on port improvements, the provision of public utilities, paving, and the like;
3. Loans to railroads and other transportation companies;
4. Share investments in banking and loan companies;
5. Share investments in mining companies;
6. Share investments in agricultural and pastoral enterprises.

The tendency in general, it may safely be said, has been to carry public improvements about as far as the population and resources of each country justify. It is doubtful whether governmental loans can be obtained or—in an economic sense—are really needed, except to tide over the emergency created by the war; in that event they should obviously be short-time and well-secured. It is doubtful, also, whether there are many railroad enterprises projected which can be expected to show profit in the near future.

On the other hand, there are probably many opportunities for highly profitable speculative investments in mines, lands, cattle,

financing concerns, and the like. The difficulty here lies in the fact that such investments require close personal attention; no sensible investor will put his money into them unless he is thoroughly convinced by his own investigation of the soundness of the project and of the efficient character of the management. Inasmuch as very few Americans, relatively, are willing to live abroad, there is comparatively little scope in this country for promoting enterprises of this nature. This attitude may in the course of time change, and the American market may in this respect come to resemble more closely the English market; but that remains to be seen.

It would seem from this foregoing review that there is very little chance of American investment on a large scale in South and Central American countries. However, there is another possibility to be considered. In many cases the pioneer risk has already been taken by European investors and enterprises have now reached the stage where they may be regarded as dependable profit-makers. At the same time, the depreciation of security values in European markets makes it possible to obtain shares and debentures of these enterprises at attractive prices. Practically all the securities of South American national governments, muncipalities, railroads, land mortgage companies, and the like, which are traded in on the London exchange, may be had today at prices far below those prevailing in normal times. This would seem to open the most natural and safest method of investing American capital in the enterprises of our southern neighbors.

This method, however, has not been utilized as largely as was expected by some observers a few months ago. Argentine rails have been advertised, it is true, in the New York market, and it is reported that there has been a considerable volume of transactions, but other South American securities (apart from the Argentine governmental loans floated in this country) are as yet little better known in this country than they were three years ago. There may be a number of causes for the unwillingness of the American investor to place his money in foreign securities, but the basic cause is undoubtedly the simple fact that these securities are not yet offered at prices which make them truly attractive. Judged by European standards of safety and income which prevailed before the war, many of them are genuine bargains; judged by American standards, they are no more attractive than hundreds of well-known domestic securities.

If the war continues, it may well be that financial necessity will drive the prices of these South American securities in the London market down to a level that will make them readily transferable to American investors. If this condition is not reached during the war, it may be reached during the period of rebuilding and scarcity of capital which may be expected to follow the war. There may also be financial reorganizations of South American enterprises which will create attractive opportunities for investment. In the meantime, in the absence of exceptionally good offers, it is to be presumed that American capital will, for the most part, be profitably employed at home until the financial bargain day for international securities arrives.

This brief paper has necessarily dealt only with the most general features of the situation. The specific opportunities offered in each of the Latin-American countries will be more fully presented in the pages following. It should be borne in mind that many of the specific opportunities may be unusually promising and may attract capital, even though there is no strong tendency toward American investment south of our own border. In Cuba, for example, the conditions are much more favorable, and are also much better known in this country, than are the conditions in most other Latin-American countries.

Making these reservations, our general conclusion must be:

1. There is little probability of investment of fresh capital from this country in South American countries on a large scale in the immediate future;
2. The time does not seem to be ripe for our purchase on a large scale of South and Central American securities now held in Europe.

Both these conclusions are subject to modification as the general financial situation changes; possibly in a year from now both of them may require complete revision.

## ARGENTINA

By JOSEPH WHELESS,
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A recent editorial in *La Prensa*, the great daily of Buenos Aires, summed up the situation as it exists not only in Argentina but in all the continent, saying: "Immigration and capital are the keys which will open the doors of the great treasure which is in South America." The reasons behind this aphorism will be exposed in brief paragraphs.

*Population*. The Argentine is as large as the United States east of the Mississippi, plus the first tier of states on the west, its area being 1,153,419 square miles. The population, according to the new census of 1914, is 7,885,237. The "density of population" is thus seen to be very attenuated, about 6.8 for the whole country. But of the total population quite one-fifth is concentrated in the single city of Buenos Aires, while maybe as many again inhabit other of the larger cities of the republic; thus materially reducing the average of rural density. These data synthesize the economic situation of Argentina: millions of acres of vacant and cultivable lands, with millions too few of people to occupy and develop the land. Hence, one of the first needs of Argentina is capital to be used in attracting immigration, inducing an increase of population to cultivate and make productive the extensive areas of land now lying idle and barren because of the dearth of hands to till it. The requirements and the opportunities in this field of investment are unlimited.

*Government revenues*. The governments, national and provincial, are in constant need of borrowed capital to meet the deficiencies of their own revenue. Referring to the national government alone, *La Nación*, a foremost journal of Buenos Aires, in a study of national finance on August 15, 1915, made this remarkable summary:

> A complete statement of all the national revenues from every source, and of all the expenditures of every kind by the government, between 1864 and 1913, shows the enormous deficit of $757,657,127 gold. There is not a single budget since the beginning of the national government, which has closed with a surplus; and it can be stated as a rule that the government has always spent twenty per cent more than the product of its revenues.

These constant deficits have always been met by new loans and by a continued increase in the scope and rate of taxation. Argentine foreign loans have mostly been floated in England, with a couple of

recent experiments in the United States. The national public debt on January 1, 1915, amounted to $545,023,470.14, gold, of which amount the foreign debt was $312,423,556.54. The figures of the provincial and municipal debts are not at hand, but they are relatively large. Argentina has not defaulted in the service of its public debt for many years, and met it faithfully during the crisis precipitated by the European war. The estimated national revenues in the 1916 budget were approximately $300,000,000, paper pesos, equal to about $126,000,000 United States gold.

*Railroad development.* The railroads are another great consumer of capital, with ever increasing needs as the system is developed and extended, a process which the comparatively level surface of the country, and its constant development, render both necessary and comparatively easy. The present mileage of the republic is about 35,000 kilometers or 21,700 miles, representing a capital of some $1,210,475,331 gold pesos. Several of these lines are owned by the government, but the greater part represents foreign, and mostly English, capital. Investments in railroads in the Argentine are considered safe and sure of good returns.

*Shipping and foreign markets.* Besides internal communications, as represented by the railroads, Argentina is endowed by nature with an incomparable network of "flowing roads" (*los caminos que caminan*) in the happy phrase of President Sarmiento. Great works have been and are being carried out by the national and provincial governments for the improvement of their rivers and harbors, the creation of great ports, both fluvial and maritime, the building of canals, and the development of the great foreign commerce of the nation. Argentina is wholly dependent upon Europe and America for the market for the sale of its products and for the purchase of its manufactured supplies of every kind. The country produces only "bread and meat," the products of its broad farms and cattle-ranges; it must purchase and import nearly all the other necessaries of life. Therefore, it needs great capital to develop its every means of communication, from the inland to the seaboard, and from the seaboard to the markets of the world. Adequate shipping facilities are acutely needed, and greatly increased banking capital is required, to handle its exports and imports and to develop its commerce abroad as well as at home. In all these activities there is great and growing need for foreign capital.

*Industries.* As indicated, Argentina has but small and wholly insufficient industries other than those connected with agriculture and meat products. General manufactures are almost entirely wanting. One of the prime needs of the Argentine for capital, as expressed by its delegation to the Pan-American Financial Conference at Washington, is for the attracting to the country of foreign manufacturers, and the establishment of plants for the manufacture

of all classes of manufactured necessaries, as well as for the development of such as now exist in the country. As part of the industrial development of the country, will be the need for a great extension of the telegraph and telephone systems, requiring heavy investments of capital.

In a word, the Argentine is an almost virgin field for the employment of capital, and great are the rewards awaiting American enterprise and industry in helping Argentina to realize her destiny as the foremost of South American States.

## BOLIVIA

BY J. C. LUITWEILER,

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It is difficult to outline Bolivia's needs for capital for the next ten years, since its economic condition is so dependent upon the success of the mining industry which constitutes the whole life of the country. Mines may be developed that will bring the country unforeseen wealth and prosperity and will make possible a more ambitious program of development than at present possible. Assuming, however, that its development will simply continue its normal course of former years, its needs may be grouped as follows:

*Railroads.* The program of the government includes the completion of one road now under construction and the building of three new lines: (1) Oruro-Cochabamba road, tapping a rich agricultural country, almost finished and lacking only 28 miles. The Bolivia Railroad is building this line, but the work is now at a standstill. They estimate that approximately $1,000,000 is needed to complete it. (2) La Paz-Yungas line, which is to extend from the country's capital (altitude, 12,500 feet) down into the tropical region (several thousand feet lower). The government is trying to secure a loan of $2,500,000 to go ahead with its construction, though a much larger amount will doubtless ultimately be needed, since 100 miles must be built to reach important country and the construction is most difficult. (3) Potosi-Sucre road, 110 miles long, to give a railroad outlet to Sucre, the former capital of Bolivia and a city of 40,000 people. A loan of $10,000,000 is sought for this road. (4) Atocha-Tupiza road. It will be a short stretch of 60 miles. When built it will connect with the Tupiza-Quiaca line, now under construction, and will thus link the Argentine railroad system with Bolivia's, giving through connections between La Paz and Buenos Aires in a trip of five days. It will be most difficult construction. As it is now under concession to the Bolivia Railroad

Company and it is not known whether that company expects to undertake it during the life of its concession, no recent steps have been taken looking to its construction.

*Public Utilities.* The government has had studies made by an English engineer of water and sewage systems for four of the principal cities, namely, La Paz, Cochabamba, Oruro and Potosi, to cost approximately $4,500,000. Another work of importance is the construction of an irrigation system for the Cochabamba Valley, a rich farming country capable of supplying food products for the whole country if it were irrigated. No estimate of the cost of this work has been made.

*Private Industries.* There is little chance of Bolivia's doing anything in an industrial way. The market in the country is relatively small and high freight rates to the coast make most export business unprofitable. The development of hydro-electric power for the mines and an electric smelter for tin and other ores are needed, if they can be built and operated on a business basis. Undoubtedly foreign capital will become interested in the mining industry, and in proportion as it does, the rest of the above program will become feasible.

## BRAZIL

By ANDREW J. PETERS,

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Hardly any portion of the world is so richly endowed with natural resources as is Brazil, but they are often difficult to reach and to convey to their proper destination. Thus the primary need for capital in Brazil would seem to be railroad expansion. The completion of the great road between Cuyabá and Santarem, the linking up of the state of Matto Grosso with eastern Bolivia, the Madeira Valley, and eventually of the Rio Negro and southern Venezuela and Colombia will have results as important as those of any transcontinental railroad ever constructed. Less tremendous in extent, and, of course, in consequences will be the further railroad development of southern and of northeastern Brazil. Southern Brazil will be one of the world's cattle regions, but its successful development in this direction will largely depend upon adequate transportation facilities. Northeastern Brazil, from Pará to Recife, faces a similar situation and will remain with its resources hardly scratched until a comprehensive and constructive railroad program is realized.

Railroad construction on this scale (and the main lines indicated would furnish relatively less mileage than has Argentina) would

be extremely costly. The Cuyabá-Santarem railroad will probably cost about twenty-five million dollars, and the roads through more difficult territory correspondingly more. Perhaps two hundred and fifty million dollars is the minimum amount needed during the next two decades for railroad construction absolutely indispensable to the full economic development of Brazil.

In this respect, of course, Brazil differs only in the size of her problems and, perhaps, in the abundance of the return upon the investment, from her American neighbors. As in other countries the confidence necessary to warrant investment on this scale can be secured only by the healthy development of Brazilian commerce as at present conditioned, by sound public finance and by a correct understanding of the responsibility of the state for the stability of credit. Brazilian commerce is eminently satisfactory if one considers the complete dislocation of some of the chief currents of trade for the Republic's great staples—coffee and rubber. The future gives every promise of a brisk demand for all that Brazil can sell in these fields and in many others for which the market will probably exist in the United States and in Europe. The present alert Minister of Finance proposes to send to this country a delegation precisely for the purpose of studying the possibility of creating here a steady and dependable market for other Brazilian commodities than rubber and coffee.

## CHILE

BY G. L. DUVAL,

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A slender strip of land 2,600 miles long, in some parts scarcely more than a ledge, separating the Cordillera from the sea, Chile enjoys a variety of climate and products but is essentially a mineral estate. Divisible into three zones—semi-tropical, temperate and rugged—its northern limit is a species of oasis, bordering a vast desert which is nevertheless the most prolific contributor to the national wealth by reason of immeasurable deposits of nitrate of soda, furnishing a monopoly of that commodity.

The late Sir William Crooks, renowned physicist, declared that the future of the world's food supply depends on Chilean nitrate. Although the largest demand is for fertilizing purposes, it is a requisite in the manufacture of acids and high explosives. Germany and her Allies, deprived of supplies, have exploited a synthetic substitute (nitrogen from the air) which is unlikely to be a serious competitor after the war when the inexpensive Chilean nitrate will

not be surcharged with the high ocean freights now prevailing. In any case, consumption increasing progressively, with new areas of demand, will undoubtedly give an outlet for supplies from all sources.

The central section of Chile is highly cultivated and in normal years supplies the country's food requirements, with a surplus for export. An extended system of irrigation from waters now running to waste would enlarge the area and product, and with shorter ocean transport, via Panama, make the famous Chilean fruit known in distant markets, give impetus to the canning industry and encourage immigration to a region where soil and climate leave little to be desired. Coal mines in the central provinces furnish a large part of the internal needs with a product 75 per cent as efficient as the best grades shipped from the United States, Great Britain and Australia.

In the southern section forests and fisheries bring us down to the Straits of Magellan, where Patagonia and Tierra del Fuego are now among the important sources of the world's wool supply. The Cordillera, flanking the entire length of Chile, is a bed of minerals—copper predominating.

The credit of the government is independent of its tax-levying power. The trunk lines of railway, the vast nitrate domain held in reserve and released for operation as required to meet a demand for its product, and the major part of the sheep-grazing lands in the south, are all held in fee by the state.

It is unlikely that the government will undertake any large public improvements in the near future unless money is in more plentiful supply than at present indicated, so its requirements for capital will probably be to meet any of its loans that may be maturing. American capital meeting this requirement will partake of the good-will that has attended earlier accommodations and brought much good business in its train. Such resourceful interests as are already enlisted in mining industries assure an abundance of capital for their development. Manufacturing enterprises generally, all of which are encouraged by law and many of them favored by local conditions, especially the canning industry, already adverted to, will doubtless make attractive appeals to American capital in the ensuing period.

The growth of our commerce with Chile has been phenomenal—$10,000,000 in the year ending June 30, 1900, contrasts with $43,000,000 June 30, 1914, which latter will probably show a further advance of 50 per cent in the current year. About 40 per cent of the total represents exports. How far we shall be able to hold the recent increase of shipments due to the European war will be a problem on the return of peace, when competition is restored. It is probable that our advantage can be held only by the methods originally employed by European countries in securing the trade: all the elements of commerce—manufacturer, merchant and banker—working

together, each helping himself by helping the others. Under American practice there has been no *esprit de corps*—each factor in commerce striving for itself regardless of, and often to the disparagement of, the others, disdaining, moreover, the slower and securer methods of developing business for the quicker way of doubtful tenure. The chief grievance of commerce is against the financial element, which when disposed to assist at all usually favors its newly created agencies or affiliated interests, ignoring and losing the invaluable experience acquired by older and established organizations.

## COLOMBIA

BY EDWARD H. MASON,
Glencoe, Illinois.

While the needs for capital in Colombia in the near future are not materially different from what they have been in the years just prior to the European war, there has been a great change in the method and direction of getting these needs satisfied.

Heretofore, on account of a variety of reasons which need not be dwelt on here, the Colombian capital seeker usually went to the European market and the American capitalist on his side seemed quite willing to have these applications pass on to London or the continent. Now the realization that the United States is the principal source of supply still open to the partly developed countries of South, but more especially the interested and sympathetic treatment given Colombian projects here, instead of the perfunctory consideration of a few years ago, has turned their capital seekers decidedly to this market.

For convenience we may divide Colombia's capital needs into those of the national government, the departments or states, the cities, and those of private concerns. The national government needs capital primarily to finance the substitution of a gold secured currency for the present non-redeemable paper money system. After this the great need of the country is for capital for the construction of public works, and of these the national government considers of first importance the improvement and sanitation of some important sea-ports. This work the government will probably handle direct and finance it with its own securities. The extension of existing railroad lines and the building of some others in the development of a general plan for a national railway system make the next great need for capital, and the national government, although directly interested by reason of its railway subsidies and its rights of reversion in the various properties when the periods of

their concessions have expired, may here limit its activities to coöperating with the existing private companies, or, as in the case of two concessions for needed railways authorized lately, may offer them first to the departments in which the lines are located, and departmental loans will have to be sought to carry through the work.

Up to recent years no attempt has been made by the larger cities of Colombia to finance their growing needs by the issuance of municipal bonds, and their public improvements have been of very slow growth in consequence. The last few years, however, have seen a great change in public opinion in this respect, and a number of the larger cities are realizing the necessity of putting in adequate modern water service with proper sewerage and street paving, are planning to build or are acquiring their street railway systems, and will be in the market for the necessary financing for these improvements.

As regards capital for private uses, the lack of straight banking capital in Colombia is a great handicap to the country, and there is much need of capital for long-term mortgage loans on city and farm property. At present banking capital is limited and discount rates very high. This limits commercial enterprise and is prohibitive for real estate loans, as is also the fact that it is difficult to secure anything but short-term accommodations. Loans on real estate at anything like reasonable rates and for longer terms would stimulate building operations of a much needed character in the cities and would enable many a cattle raiser to better his stock or to put some of his big grazing tracts to a more profitable use.

## COSTA RICA

By Walter Parker,

General Manager, New Orleans Association of Commerce; Chairman Permanent Committee on Costa Rica, Pan American Financial Conference.

An abundance of water power, undeveloped mines of great wealth, agricultural possibilities of wonderful potentiality and adequate shipping facilities should enable Costa Rica to assume a mortgage far beyond the power of the average Central American republic. The natural wealth of the republic has hardly been touched.

The effect of the European war is similiar to that felt by the other republics. One of the results is the hastily formed Banco Internacional, founded by the government to meet the unusual financial conditions created. This is a bank of issue, having a capital consisting of Costa Rican treasury bonds. The reserve

required by law for banks of issue is 40 per cent gold. Present rates on commercial loans are high, running all the way from nine to twelve per cent. It is said to be the desire of the President of the republic to convert the Banco Internacional into a general mortgage bank, and induce the three or four commercial banks to combine and form one commercial bank. It is believed that this will increase the total banking power of the republic, decrease rates of interest and provide for the extension of rural credits. By inaugurating this plan the combined capital of five Costa Rican banks would approximate less than $5,000,000.

The most urgent need of the Costa Ricans is adequate credit facilities. We must become fully cognizant of this need before we attempt anything. It is now possible, through the agency of the Federal Reserve Act, for the national banks of this country to coöperate more fully.

Heretofore the merchants of Costa Rica have availed themselves of the extremely favorable terms of the European markets. The rates of interest were almost invariably more liberal than those to be had in the United States. Now that the bankers of this country can give their acceptance to long-sight drafts arising from exports and imports, a means is at hand to in part overcome this obstacle. Having grown accustomed to paying his bills every six months, it is a difficult matter for a merchant in Costa Rica to adapt himself to the rapid ways of American business, but it does not necessarily mean that he is trying to evade payment of his obligations.

Even if the United States goes after and gets its proportion of the business of Costa Rica, there still would be something left to be done. The republic needs more than the mere influx of American-made-goods; it needs American capital and brains as well. Under prevailing conditions, the railway situation, with some improvements, would be about adequate. There will be need for more railways when the other development necessary has proceeded, but at present there is scant need for more transportation improvement. The mining and agricultural features of Costa Rica should make an irresistible appeal to the American investor. When these have been taken in hand and are producing their proper percentage of the country's wealth, there will be less dependence upon the custom house.

Any casual investigation of the opportunities in Costa Rica cannot help but reveal the wonderful openings to be had there by American capital. But it is well to look into every angle of the situation before attempting investments. Nothing that has ever been written about the mines, water power and the agricultural extent of the republic, can be made to convey the idea that is only to be had through personal investigation. And the man who undertakes to seek out the best forms of investment in Costa Rica must

go into the country free of prejudice or set opinion. He will encounter one surprise after another, and in some instances he will be amazed to learn the progress Costa Rica has made in certain directions.

The people of the United States are now looking forward to the establishment of rural credit banks. There can be no doubt but that these institutions will exert a wonderful stimulus on agriculture in the United States. But the idea is not new to Costa Rica. Rural banks to aid the farmers in getting money under favorable conditions have been in operation for over a year. This system is under the management and control of the government, through the agency of the Banco Internacional. A mortgage department now is contemplated with a capital of 500,000 colones, or approximately $200,000.

Practically every essential element favorable to the investment of capital may be found in Costa Rica. The money that is used in developing its resources must be invested with an eye to the future of the country, and not for quick exploitation and immediate return. A steadily increasing wave of resentment is becoming apparent in Latin America against the evanescent effects of the exploiter. The people realize their own deficiencies for want of money, and will go more than half-way to welcome and assist the honest, well-intentioned American capitalist. It would help greatly were the national debt refinanced in the United States.

## CUBA

By A. G. Robinson,
Washington, D. C.

We may safely assume that Cuba will want money in the immediate or early future, but a wide difference stands between wants and actual needs. There, as in other lands, the gratification of wants is limited by the ability to pay for them without an unwise stretch of borrowing power. In Cuba's case, a special limitation appears in that appendix to its Constitution, commonly known as the Platt Amendment, imposed by the United States at the time of the transfer of government to Cuban hands, in May, 1902. In Article II, that instrument declares:

> That the Government of Cuba shall not assume or contract any public debt, to pay the interest upon which and to make reasonable sinking-fund provision for the ultimate discharge of which, the ordinary revenues of the Island, after defraying the current expenses of government, shall be inadequate.

Upon a Cuban Congress inclined to any substantial increase in Cuba's present national debt, the government of the United States would, in all probability, lay a restraining hand unless it was fully assured of Cuba's ready ability to carry out the provisions of this clause in its fundamental law. Many Cubans, like many Americans, want improved highways in the region of their particular interest. Many want new official buildings and schoolhouses. But the need of roads and public buildings is not, in most cases, imperative, and the exceptions should be met from the current revenues, now far greater than ever before in the history of the island.

Cuba's industrial enterprises are at present represented chiefly by the production of sugar and tobacco. An important part of the output in both lines is now controlled by American investors. Encouraged by the present enormous profits in the sugar-raising industry, due to the abnormal price enhancement caused by the suppression or derangement of a large part of the European beet sugar industry, an organization has recently bought established mills and plantations in the island, to the amount of approximately $50,000,000 in actual cash. A large part of this was American money. More millions have been invested by other Americans in the improvement and extension of sugar properties already owned by them; in the purchase of mills from Cuban or other owners; and in the erection of new mills and the cultivation of new areas.

The percentages have been somewhat changed by the abnormal price of sugar, for the last two years, but the place held by that commodity in Cuba's industrial life, under normal conditions, is shown by the fact that it ordinarily represents nearly three-quarters of the total exports. Tobacco, in various forms, represents nearly one-fifth, and the remainder is accounted for by various products such as iron ore, copper ore, and manganese; by timber, animals and animal products, sponges, beeswax, and others. The iron deposits of the eastern part of the island, of American ownership, are certain to become of large importance. The railway systems, at present fairly meeting the needs of the country, are largely of British ownership.

In summary, it may be said that there appears no present prospect of important money demand from Cuba in the near future.

## DOMINICAN REPUBLIC

By Jacob H. Hollander,

Professor of Political Economy, Johns Hopkins University, Baltimore, Maryland.

The Dominican Republic, like the imperfectly developed states of Central and South America, is in urgent need of economic enterprise and financial investment. The land is rich in natural resources that await only the touch of energy and capital to pour forth streams of wealth for the enrichment of the island and the betterment of the world. The primary requisites are, of course, stable government, political quiet and social tranquillity. The history of the last ten years shows unmistakeably that these are possibilities definitely within reach, and that the coming decade is likely to witness a final passing of the old turbulence and disquiet.

Beyond these primary requisites one of the essential needs of the republic is an improved system of currency. The currency situation in the Dominican Republic is unlike that of any other country in Central or South America. The only money in circulation is United States currency. This is at once the medium of exchange, the measure of value, and the standard of deferred payment. In years past, various forms of Dominican currency, metallic and paper, were emitted, but all of these have been demonetized and withdrawn from circulation. Certain banking institutions have been vested with powers of note-issue, but the conditions attending the creation and activity of these institutions have not been such as to secure public confidence in the notes and it has been practically impossible to put them into circulation.

The currency problem of the Dominican Republic is thus largely one of inelasticity, the sources of supply being the United States or Porto Rico. It is inconvenient, expensive and inadequate to meet the varying currency requirements of an agricultural country by remittances back and forth.

The sufficient remedy for this condition would be the establishment of a branch of a member bank of the Federal Reserve banking system in Santo Domingo city with agencies in three or four of the other large cities of the republic. The note-issuing power of such a member bank would make it possible for the circulation of the Island to be expended at crop moving time and to be contracted thereafter. It would stabilize exchange between the Dominican Republic and the United States, as well as with other foreign countries. Finally, it would prove of great convenience to the United States customs receivership in making remittances to the United States pursuant to the terms of the convention of 1907.

## ECUADOR

BY. F. I. KENT,
Vice-President, Bankers Trust Company, New York.

The government of Ecuador has very small outstanding obligations outside of its guarantee of the sinking fund and interest of the bonds of the Guayaquil & Quito Railway. Such bonds outstanding at the moment amount to $12,712,000, and as the railway has never paid anything upon its obligations, the government of Ecuador has been obliged to carry the whole burden. On February 1, 1916, the government was in arrears in payment of interest on the Guayaquil & Quito bonds $1,878,975, and it had issued bonds in payment of interest that had previously accumulated for $636,480, on which the interest in arrears is $38,189, so that it was actually behind in interest payments under its guarantees $2,553,644. The only other external debt of Ecuador is the "Condor Bonds," which represents the balance outstanding of the Debt of Independence, and amounts to $387,342. Since the war the government has defaulted on all its interest payments. This has been due to the decrease in revenue that occurred because of the stoppage of the foreign trade of the country after the declaration of war. As Ecuador depends largely for its revenue upon customs duties and export taxes, as is true in the case of many other South and Central American countries, the temporary stoppage of its foreign trade was seriously felt. It had to increase its internal borrowings, which were mostly from Ecuadorian banks, and they have reached a total of $7,165,000. The foreign trade of the country is now picking up, but in the meantime Ecuador has been left with a large floating debt and past due obligations.

The country has wonderful natural resources, and with proper development should be able to increase its foreign trade very materially. Before it can do so, however, it will be necessary to have the sanitation of the port of Guayaquil completed. While this port is at present much more free from disease than is generally supposed, yet because of past epidemics, ships entering Guayaquil are quarantined before being allowed to approach other Pacific ports. This of necessity hampers the foreign trade of Ecuador very considerably, but there are good grounds for believing that once Guayaquil is recognized as a clean port, the revenue of the country, due to the increased foreign business that it is reasonable to suppose would ensue, should increase very materially. Unless Ecuador is able to obtain a loan of considerable size, it will not be possible to complete the sanitation work of Guayaquil, except by piecemeal from year to year, as funds can be spared from the revenue. This

will carry the necessary improvements over such a period of years, during which time the foreign trade of the country will be seriously affected, that it is most important for the interests of the people of Ecuador that the government obtain the money to do the needed work at once.

Certain parts of the country are still without proper railroad facilities, even taking into consideration their present undeveloped state, and if a comparatively few miles of road could be built, it should prove of great benefit to the people. In order to refund all outstanding obligations, complete the sanitation of Guayaquil and make the railroad system thoroughly effective, it is figured that Ecuador will be obliged to borrow about $30,000,000.

## EL SALVADOR

By FREDERICK F. SEARING,

Paterson, N. J.

The area of Salvador is 7,225 square miles; it is about the size of the state of New Jersey which has an area of 7,525 square miles and has a population of 1,250,000. Its density of population per square mile is just about one-half that of the state of New Jersey. Almost all of the available surface of the country is under cultivation. Nature seems to have assembled and combined all of the various elements that are necessary to the successful production of coffee, about 65,000,000 pounds of coffee being exported each year.

Salvador has the best record of any of the Central American republics for looking after its credit. Its public finances heretofore have been in charge of the English, the only foreign loan that Salvador ever issued having been floated in London in 1908. This loan amounted to £1,000,000, sterling. It bears interest at the rate of 6 per cent per annum and a sinking fund is provided, consisting of 2½ per cent of the principal amount of the bonds, redeemable in each year. The loan was floated by the London Bank of Mexico and South America and Messrs. Chalmers, Guthrie & Co. of London. It was listed at once on the London stock exchange and has been regularly traded in on that board ever since. Payments of the interest and sinking fund on account of this loan were regularly made from the date of its issue until the month of August, 1915, when, owing to the decrease in the revenues derived from duties on imports and exports occasioned by the war in Europe, the Minister of Finance made a proposition to the holders of the bonds that they deposit their coupons representing four years' interest on the principal of the loan with the trustees for the loan

in London, who would issue certificates of the government representing the coupons so deposited, bearing 7 per cent interest. This proposition was accepted by the holders of the bonds and was formally put into effect in the month of December, 1915.

The progress of Salvador is effectually shown by the following figures:

| | | |
|---|---|---|
| 1899, total revenues from all sources, | $4,435,695 | silver. |
| 1900 " " " " " | 6,297,274 | " |
| 1905 " " " " " | 8,536,443 | " |
| 1910 " " " " " | 10,620,866 | " |
| 1912 " " " " " | 14,445,731 | " |
| 1913 " " " " " | 13,734,133 | " |
| 1914 " " " " " | 12,423,752 | " |
| 1915 " " " " " | 10,625,173 | " |

It will be noted that in the year 1899 the total revenues of the government from all sources amounted to $4,435,695 silver, and in the year 1912 the revenues of the country had increased to $14,445,731 silver. It will also be noted that the revenues for the year 1915 amounted to $10,625,173 silver, the decrease having been occasioned by the outbreak of the European war. During the present year the turning point was reached and at the present time the revenues of the country are gradually increasing.

The best opportunity for the employment of capital in Salvador at the present time is in the establishment of a government bank. There are three chartered banks of issue in the republic, and their notes form the paper currency of the country. The government does not issue any paper money. Aside from this, the money is silver coin. The value of the silver dollar or *peso* is about 42½ cents American gold. The National Assembly granted a charter for an agricultural bank in the year 1914. The present banking facilities of Salvador are insufficient, and if a new institution were established it would have the hearty support of the government and would unquestionably do a very profitable business. Banking in Salvador is based on the movement of merchandise in and out of the country. This is the safest kind of banking. Rates of interest are good, being greater than those prevailing in the United States, and the security for loans is the best in the world.

Salvador also needs more railways. There are three railways now operating within the republic. The Salvador Railway, which runs from the port of Acajutla to the capital city, San Salvador, with a branch to the city of Santa Ana, in all having a total trackage of about one hundred and fifty kilometers, was built in the year 1899 by an English company. It will be noted by the foregoing figures that in the year 1899 the total revenues of Salvador amounted to but $4,435,695 silver, yet in that year the government undertook to pay the English Company an annual cash subsidy of £24,000

sterling for a period of eighteen years, and this pledge the government has regularly and faithfully kept. On the strength of this agreement on the part of the government the English Company was enabled to float its own securities in London. The railroad has been operating successfully ever since. At the present time another railway is in process of construction, running from the port of La Unión, on the Gulf of Fonseca at the eastern end of the republic, entirely across the central portion of the country to Guatemala. This railway is one of the links in the Ferrocarril Internacional which is designed to run ultimately all the way to Panama. At the present time about one hundred and fifty kilometers of this line have been finished and are now in operation. The only other railway in the republic is a short line built by local capital, between the capital city, San Salvador, and the city of Santa Tecla, a distance of about fifteen kilometers.

A concession was granted in the year 1914 by the government for the construction of a railway between the capital city, San Salvador, and the port of La Libertad on the Pacific coast, a distance of about fifty kilometers. This railway is really a government enterprise. The government issues bonds to the extent of $1,500,000 gold, the proceeds of which are to build the railway. The distance by the English railway from the city of San Salvador to the port of Acajutla is one hundred and five kilometers. The new line will afford a much shorter route to the coast. La Libertad is the natural port of entry for the city of San Salvador, and the construction of this railway will open up a very rich territory and will be of great benefit to the government.

The mineral resources of Salvador have been scarcely touched. There are several English mining companies and one or two American ones that have been operating successfully for a great many years in the eastern part of the republic; but there are vast mineral resources in the mountains to the north bordering on the Honduran frontier which have not been developed.

Deposits of petroleum in the eastern part of the republic have recently been discovered. A great deal can be done in Salvador by developing the water powers of the country. There are several of these within the republic.

An opportunity is open to enterprising American contractors for the paving of the streets of the principal cities. The city of San Salvador has spent a great deal of time and money in the preparation of plans and details for the paving and sewering of the capital city, and it was about ready to go ahead with this work when the European war broke out.

Salvador occupies a very strategic position among the five Central American republics. The Gulf of Fonseca, which is the only land-locked harbor between San Francisco and Panama, is

situated at the eastern end of the republic. On the Nicaraguan shore of this gulf the United States government purposes to establish a naval base. The islands within the Gulf of Fonseca belong to Salvador and that of Meanguera commands the entrance to the Gulf. The President of the republic is anxious to see established on this Island a free port similar to that on the Island of Curaçao, off the coast of Venezuela. His idea is that, if warehouses, dry docks and coaling stations for ships were erected on this island, the merchants of foreign countries could ship their goods in bulk to this port, where they would be entered free of duty. By such an arrangement wholesale stocks could be carried in this central place and the different countries supplied from that point. Inasmuch as three of the republics border on the Gulf of Fonseca, the transshipment of goods in small quantities to the respective countries could easily be accomplished. A concession for the establishment of such a port was granted by the National Asembly in the year 1914.

The opportunity is open to American merchants to capture the entire Pacific trade of Central America by establishing themselves at this time in Salvador. The country has been singularly free from revolutions, the last outbreak of this nature having occurred as far back as 1895. The republic has a stable government which changes every four years by the ballot instead of the bullet. The people are industrious and the climate is salubrious. There is an entire absence of the fevers peculiar to the countries in the latitude of Salvador on the Atlantic side. This is chiefly because the country is hilly and well drained; also on account of an absence of low-lying marshy lands.

To conclude, Salvador is well worthy of a visit and the serious consideration of American capitalists who may be contemplating investing in Latin American countries.

## GUATEMALA

BY JOHN CLAUSEN,

Manager Foreign Department, The Crocker National Bank of San Francisco.

The Republic of Guatemala, situated East of Mexico, covers an area of about 50,000 square miles, with an estimated population of 2,120,000 inhabitants—the largest of any Central American country—of which 125,000 reside in the capital, Guatemala City. The name "Guatemala" is probably of Aztec origin and is said to mean "Land of the Eagle." The bulk of its people are located in that half of the Republic bordering on the Pacific with few settle-

ments on the North or on the Atlantic side. Its mountain ranges, with very little exception, give the country an elevation of from 4,000 to 11,500 feet. The Pacific slope is very fertile and produces large crops of coffee, corn and sugar; while on the Atlantic side there is found very little agricultural wealth except from the cultivation of bananas in the lowlands and near the coast. The production of coffee, however, is the principal money crop of the country—moved largely upon funds that have been advanced for that purpose—and to its marketing, therefore, depends much of the prosperity of the Republic.

According to the report of the Secretary of Finance of the government of Guatemala, made under date of April 14, 1915, its debt amounted to $13,304,759.79 United States gold, made up as below:

| | |
|---|---|
| English debt.................... | $11,785,314.39 |
| Internal debt.................... | 1,519,445.40 |

Their external obligation consists of what is called the English debt of 4 per cent which was not contracted by the present administration but dates back from the time when all Central America was one Federation of Republics, or in other words, since the independence of Guatemala which was established in the year 1821.

Upon the breaking up of the Federation three-fourths ($\frac{3}{4}$) of this obligation fell to Guatemala, while the remainder, but one-fourth ($\frac{1}{4}$), was allotted to the other four republics. Subsequent administrations increased the debt by additional loans and delinquent interest, until it reached the aforementioned figure. No new foreign loans have been contracted by the present government, although it is learned that negotiations have recently been opened towards the placing of an additional $3,000,000 United States gold for municipal improvements in the City of Guatemala.

Only during the last few years has Guatemala effected a material settlement with its English creditors in resuming payment of interest. The services of the English debt require only $300,000 United States gold annually for interest, which are conveniently cared for as the republic has a favorable trade balance of approximately $3,500,000 United States gold and a net internal revenue of $1,000,000 to $2,000,000 United States gold. In naming these figures, however, it must necessarily be taken into consideration that the European war, together with prevailing inadequate transportation facilities, will tend to decrease the government revenues as also customs taxes which as has been stated represents the larger portion of their income. The internal indebtedness has been found difficult to liquidate with the result of constantly increasing the obligation by delinquent interest payments.

The English loan, however, in spite of the expenditure of large sums on public works and charitable institutions of the country, has

received its interest in advance and this feature is being very favorably commented upon by British capitalists. These bonds have been quoted during the greater part of the year at 40 to 41, netting the holders nearly 10 per cent per annum. Unlike many other Latin American republics, the municipalities of Guatemala have no bonded indebtedness and their temporary advances from local banks are automatically repaid from taxation.

Authorities affirm that it would take approximately $12,000,000 in gold to place and maintain the country on a gold basis.

The yield of the public revenue in 1915 was $85,007,704.74 G/P pesos, as against $82,399,924.55 G/P pesos in 1914. Public expenditures for 1915 were $67,841,283.64 G/P pesos, which exceeded the amount estimated by $7,778,643.65 G/P pesos.

The total value of trade in 1915 was $16,369,061.99 gold as against $22,085,141.48 gold in 1914. On the other hand between the imports amounting to $5,072,473.03 gold and exports aggregating $11,566,585.96 gold, there was left a favorable trade balance for Guatemala of $6,494,109.93 gold.

Two causes especially affect Central American trade and finance, the loss of the usual markets in Europe and the inadequacy of transportation facilities. The Republic of Guatemala in particular lost its normal outlet for coffee, the largest of its export commodities.

A very cordial feeling has been developed in Guatemala towards the United States and while a good portion of their imports originate in this country, a much larger percentage of business transactions should be exploited as a result of the favorable opportunities at present. To make our appeals forcible it becomes necessary to invest more capital in the republic, to extend more liberal credits, to improve banking facilities for export trade and to make more direct and personal efforts in their markets. At present they need financial assistance and shipping facilities perhaps more than other Latin American countries. It is essential for the maintenance of the foreign purchasing power of Guatemala to lend help in developing and marketing their products abroad.

The comparative tables which follow show the importance of our trade relations with that republic:

| EXPORTS from Guatemala to— | |
|---|---|
| Germany | $5,412,580.30 |
| United States | 4,874,379.19 |
| England | 1,476,706.48 |
| France | 34,185.75 |
| | $11,797,851.72 |
| Other countries | 956,184.89 |
| | $12,754,036.61 U. S. gold. |

IMPORTS into Guatemala from—

| | |
|---|---|
| United States | $4,879,200.04 |
| Germany | 1,842,738.04 |
| England | 1,389,645.00 |
| France | 317,631.11 |
| Japan and China | 221,462.55 |
| | $8,650,676.74 |
| Other countries | 680,438.13 |
| | $9,331,114.87 U. S. gold. |

There are at present about five hundred miles of railway in the republic. The system includes a transcontinental line from San Jose on the Pacific Coast to Puerto Barrios on the Atlantic, considered the best built railway of any of the Central American lines with the possible exception of the Panama Railway. The Atlantic side of the republic is webbed with 200 miles of rail, 270 on the Pacific side and 30 for the interior. These roads are practically all owned by American interests and represent in a measure the only investment in that Republic of North American capital. German and English investments predominate in all other undertakings, principally that of coffee-growing.

To develop mining the government has granted the privilege of free duty on machinery and other implements necessary for the exploitation of that industry.

Ores of iron, lead, zinc, silver, lignite of very good quality, sulphur and rock salt are found in abundance. Prospecting for petroleum has recently been undertaken and the opinion exists that the search will be successful. The greatest obstacle, however, to a rapid progress of these enterprises is capital to adequately exploit the vast mineral deposits.

Grazing has also had considerable development, but there is little outgo of meat products, most of the cattle being consumed in the country with only the hides for export. There is much talk at present of developments in cattle raising and the government seems disposed to lend assistance to any proper venture of this kind.

It seems easier for the Central American to live on the products of his own country than for most other people and this particularly is true of Guatemala which is primarily an agricultural country with comparatively little manufacturing and scarcity of capital for its development.

## HONDURAS

BY W. S. VALENTINE,

President of the New York and Honduras Rosario Mining Co., New York City.

Honduras, a country of scarcely half million population, in a territory covering some fifty thousand square miles, with the only safe ports on both the Atlantic and Pacific, between Panama and Mexico, has remained *in statu quo*, practically since its independence, because from a capitalist's standpoint, it has not been "on the map." The main causes of this have been:—

(a) Its internal and internecine struggles, very much exaggerated, but sufficient to preclude it as a field for investment.

(b) Its enormous foreign debt, created in 1864 in London and as stated by the Select Committee of Parliament, London, 1872, "Born in the Cardinal Sin of, and carried out by, our own people in the same Cardinal Sin." This debt with interest now reaches over $125,000,000.00. Although many attempts at settlement have been made, it has never been accomplished, and until it is, the credit of the country will be *nil*. Here is an excellent opportunity for capital.

*Government Needs.* In spite of its heavy burdens, the government has managed to scrape along, paying its way in its internal budget. The eight years of political quiet, and the enlightened statesmanship of its youthful President, Dr. F. Bertrand, have assisted materially in its fiscal progress. The government really needs no direct financial help.

The flexible silver basis is a serious problem, and "capital" will have to find a way for the introduction of the gold standard. This will come when its great natural wealth is fully appreciated.

*Railroads.* The heavy debt of the country was created for railroad purposes. The country has never received anything for it, except a badly built 37 miles of road. Since then practically no construction has been attempted. There are a few banana roads, built by private corporations. Railroads are a prerequisite of the country; they are what is needed for the development and extraction of the vast latent riches. The government will grant most liberal franchises to American capitalist's constructing them. A line for an interoceanic road has been found feasible. It would be about two hundred miles long. This road would run from the magnificent Bay of Puerto Cortes, on the Atlantic, to the Gulf of Fonseca, on the Pacific. It would not only be a success financially, but is of imperative necessity to the government of the United States, since it has now virtually obtained control of the Gulf of Fonseca for

a naval and coaling station through the recent Bryan-Chamorro Treaty, signed with Nicaragua.

*Various Loans.* There are no specific requirements for loans of general character. Honduras requires development by the investment of capital. Thus development of the latent wealth will follow.

The climatic conditions are such as to allow everything in the agricultural line to be raised, from beans to cotton and wheat. The great forests of mahogany and cedar, of pine, oak and all building lumber are virgin, and grazing lands for cattle exist by the mile. The rivers are rich in gold while veins of ore are abundant in gold, silver, copper and iron, awaiting development. The laws of Honduras are very liberal for the immigrant.

The commercial interests are in the hands of a few foreigners. The "zone of commercial influence" has been the standard of England for many years, but in recent years, strongly fought by the Germans, while the American manufacturer has been dormant.

The credit on long terms is one that must be appreciated by the American manufacturer. The risk is minimum and in forty years of experience, only one failure has been noted. American goods have met with great favor since the war, and the field is now open for permanent trade; it can be held if the two salient points are considered, *i.e.*, credit and proper packing.

There is a large field for banking institutions as at present but one bank of any importance is in operation. It has only recently been established, the interests being mixed Hondurenian and American capital, and it is doing a flourishing business.

## NICARAGUA

By W. L. Saunders,

Chairman, Board of Directors, Ingersoll-Rand Company, New York.

Nicaragua is the largest republic of Central America, its area being about equal to that of the state of New York. Columbus discovered Nicaragua in his fourth and last voyage. European settlers are known to have located there before the era of immigration to the United States, yet the country has never been developed, its natural resources remaining in a virgin condition, except in the coffee industry, which has not yet been extended to the limit of its possibilities. Thousands of acres of good coffee raising land exist in the highlands, where the natural conditions are favorable for raising high grade coffee, yet these lands remain uncultivated. Coffee production on a large scale requires capital for the purchase

of machinery and plant, but the industry when properly equipped and managed is one of the surest for large returns on the investment.

The chief reason why capital has not developed Nicaragua is because of internal revolutions and political troubles. These have existed in the past with great violence and frequency, but indications now point to stability of government, which, taken with the settlement of financial conditions in the country, offers promise of the investment of capital and the development of natural resources.

The monetary system of Nicaragua, which for many years was silver, though actually based upon inconvertible paper, has during recent years been reorganized and is now on a stable gold basis. In 1912 a firm of American bankers negotiated an arrangement whereby the interest on the foreign bonded loan of Nicaragua was reduced from six to five per cent, an operation very favorable to the republic. Recently the United States Senate has ratified a treaty with Nicaragua by which the United States agrees to pay three million dollars for a naval station on the coast of Fonseca and a perpetual right to build the Nicaragua Canal. This will add much to the financial strength of the government, enabling it to pay off a portion of its outstanding bonded debt and to settle claims for damages which have resulted from former periods of political disturbance.

Low grade gold exists in many districts, and is now being profitably mined at half a dozen mines. Thousands of cabinet-wood trees are uncut. This industry is receiving some attention, but the operators are greatly hampered by lack of capital. Under normal modern conditions, this industry, as most others, must be undertaken on a somewhat large scale to make it profitable.

Many new regions fit for banana cultivation, and untouched by the banana disease, remain fallow for capital and attention. Even the lands where the banana disease has appeared have been demonstrated to be resourceful for sugar cane and for citrus fruits. There exists a chance and a need for capital. Sugar is produced very profitably already, and there is room for more.

Wild rubber is a sufficient industry to show that cultivated rubber is possible. Thousands of cocoanuts are already being shipped, proving that there is an opportunity for investment, both for the nuts and for copra and oil. Another possibility requiring attention is dye-woods, already shipped in some quantities. One of the biggest resources of Nicaragua is its cattle and cattle ranges. It possesses one of the very few regions of cattle lands in the extent of country from northern Mexico far down into South America—a resource that some day will be made much of.

All these resources, besides others such as cacao, tobacco and cotton, which are being raised in sufficient degree, profitably, to prove their possibilities for further attention from capital, need transportation. With their development will come a growing de-

mand for carrying facilities, and here is a demand for further capital. This applies to both railroads in the interior of Nicaragua and steamships for the exterior.

The present railway system of Nicaragua is confined chiefly to the Pacific coast and the Lake region. This comprises some 191 miles of track. Of these, 171 are the property of the government, though at present they are partly owned by New York bankers. The rolling stock on the railways is of American manufacture.

We have in Nicaragua a country somewhat resembling Nevada, rich in possibilities and now firmly on a gold basis, needing only the stimulus of capital to give it healthy and profitable development.

## PANAMA

By A. G. Clapham,

President, The Commercial National Bank, Washington, D. C.

Due to the Panama Canal there is scarcely a country that has been so advertised all over the world as has the Republic of Panama. On the other hand there are but few countries of which so little is known regarding the natural resources and the needed capital for development.

In my opinion the greatest opportunity for development and quick results is in the sugar, cocoanut and cattle business. The land is very fertile and sugar-cane is well adapted to the climate and will yield from 15 to 20 tons per acre more than the cane lands of Cuba; but at the present time there is very little to encourage people to raise cane as there are practically no sugar-mills and most of the cane is used in making rum or syrup for home consumption.

I was especially interested in the opportunity for the development of the cattle business. There are many thousands of acres that would make excellent grazing land and as soon as the land is cleared it runs into grass which improves by grazing. There are come very good ranches at present in Panama but the business is in its infancy and there are comparatively few cattle there compared to the demand and opportunities. I was, however, surprised to see what good grades of cattle are raised there. Many of the cattle owners are endeavoring to improve the quality of their cattle by getting bulls from the states and Jamaica. The supply of cattle at this time is not sufficient for the local demand. In the past year the United States government bought thousands and thousands of animals in Colombia and Costa Rica and shipped them to Cristobal to be used in the government commissary, and to supply the ships that pass through the Canal. This trans-isthmian ship-

ping alone creates a great demand for beef—and it is not one-third now what it will be when the war in Europe is over.

The cocoanut business is much smaller; but with increased demand for cocoanut it can be made very profitable—this with comparatively little work as the trees begin to bear at the age of seven and eight and they live to be seventy-five to one hundred years old.

There are several sections of Panama admirably adapted to growing coffee of very excellent quality. Experiments with cotton have produced a staple of much finer quality than we raise in the states. It is of a very long and silky appearance, closely resembling Peruvian cotton.

The natural resources of this little republic are almost entirely undeveloped. The opportunities there are much greater for big returns with fewer privations and less suffering than one encounters in an effort to develop the resources of many of our western states and Alaska.

There are many other industries besides the ones mentioned awaiting capital for development. Many people fear and are prejudiced against the climate; but the worst thing about it is the lack of seasonal changes. The people I met there on my several visits seemed and looked as healthy as they do in the states. The government of Panama welcomes capital and is liberal in granting concessions for legitimate enterprises.

## PARAGUAY

By WILLIAM WALLACE WHITE,

Consul General of Paraguay, New York City.

In his message to the Fifty-Sixth Congress in April of the present year, Don Eduardo Schaerer, President of the Republic of Paraguay, said:

> The European war has appreciably modified our commerce, creating new relations in our international traffic. The closing of various of the great markets having relations with South America, the difficulties in international communication, and other reasons that it is unnecessary to enumerate, have produced a visible shifting of the import and export movement, directing it in great part to the United States. The growth of relations in this direction has plainly shown the need of some means tending to encourage it.

In other words, the Paraguayan government is not only willing, but anxious, to cultivate commercial relations with the United States.

Situated in the interior of South America, away from the usual routes of travel, Paraguay is not known in the United States as are its neighbors. "The Garden of South America," as it is called, with a healthful and salubrious climate and abundant rainfall—similar in many respects to the southern United States—with forests rich in construction-, cabinet-, dye-, and tanning-woods, with broad prairies suited today for live-stock, and tomorrow for agriculture, the country is only awaiting the introduction of capital to make it one of the richest spots in the world for producing the staple necessities that are today becoming scarce. With its cattle it bids for packing plants; with its hides and tanning extracts it should have its own tanneries; its abundant and cheap timber yields railroad and shipbuilding material that will endure for generations, and cabinet-woods for the rarest uses, with commercial woods for the carriage-builder and tool-maker, and pulp for the paper mill. Sugar, tobacco, cotton, maize, rice, *yerba mate*, and all the California or West Indian fruits and vegetables thrive on its soil, and canneries and preserving plants might be established with profit.

The general need of the country is internal improvement, and, recognizing this, the government is offering every inducement to settlers, particularly to those that intend to remain, rather than to the large land holder who invests with a view to speculation. The public lands are being surveyed, and are being taken up as rapidly as they are opened.

For the full development of the country, perhaps the greatest need is improved and cheaper transportation facilities, by rail, water and highway. Transportation today between local points and to the seaboard ports is, with the exception of the Paraguay Central Railway System, carried on largely on the various rivers bounding and traversing the country. In many cases it would be profitable to dredge certain of these rivers, and it might be of advantage to inaugurate a system of swift, light-draft, steam barges to carry the products of certain localities until the permanently established character of their productions shall warrant the construction of railroads.

As to the possibilities for loans and investments in Paraguay, each proposition must be judged on its own merits. It will be well to remember that in any undertaking wherein the public weal is concerned, the government, through its appropriate departments, will do everything to facilitate the relations between the parties. American investors will have difficulty in finding greater natural and legal inducements for legitimate undertakings than are yet open in Paraguay—opportunities that are being recognized more and more by capitalists of the countries lying contiguous to the republic, who are investing in the cheap lands and establishing commercial and banking connections in every part of the country.

## PERU

By John H. Fahey,
Publisher, Boston, Mass.

Peru's most important demand for capital in the United States has been for government purposes. Efforts have been made recently to secure in this country a loan of $15,000,000 to cancel various debts and pay the interest and amortization of old loans; notably that previously obtained in the United States through the W. R. Grace Syndicate. Efforts to negotiate such a loan have been abandoned for the present, since the Peruvian government and American bankers were unable to agree upon arrangements. The government has, therefore, suspended negotiations until later and is to apply the surplus, accumulating as a result of present economies, to settlement of interest and amortization on the debt.

The first year of the war caused a large decline in government income, and at once a program of rigid economy was adopted. This is proving successful. Sooner or later the Peruvian debt will unquestionably be financed in some form, and the matter will again be taken up with bankers in this country. The total debt of the country is about $29,000,000, or about $6.50 per capita.

It is almost impossible to say what the capital needs of Peru are at present, for municipal and public work. A number of communities are anxious to improve their water supplies and are ready to grant concessions and guarantees for the necessary capital. Railroad extensions and new lines are also projected. These enterprises would undoubtedly call for an expenditure of $25,000,000 or $30,000,000, if obtainable on a reasonable basis. It is probable, however, that most of these developments will be delayed until the terms on which the capital may be obtained are much better than at present.

Investigations of various industrial proposals, as well as railroads and public works, are being made on behalf of American capitalists at present, but as yet there is no information available as to the aggregate capital requirements involved. If a government loan is arranged in this country within the next year or two it will undoubtedly aid the Peruvian situation very much from a capital standpoint and stimulate the investment of North American money in industrial and other enterprise.

## URUGUAY

By H. A. Wheeler,
Vice President, Union Trust Company, Chicago, Ill.

While Uruguay is one of the smallest of the South American republics, it constitutes a very interesting and fruitful field for commercial and financial operations. The people are almost entirely white people, the Indian and Negro strains being almost wholly eliminated. The principal sources of wealth are stock raising and agriculture, and the per capita wealth is increasing very rapidly. The government is in many respects a nearer approach to a pure democracy than any of the South and Central American nations. There are no separate states, and while the country is divided into nineteen geographical departments, the federal power is general and complete with a tendency to control, and in time to monopolize, many activities which in other countries are carried on by private persons or corporations.

Uruguay is for all practical purposes a gold standard country. It coins a limited amount of silver for fractional currency, but coins no gold, using chiefly the gold coins of Great Britain, United States, and Argentina. Its note issue is entirely in the hands of the Bank of the Republic, and must be protected by a gold reserve of, at least, 40 per cent.

At the close of 1914 the public debt of Uruguay was $143,000,000, largely held in England, France and Belgium. This debt, which represents a per capita of $107, seems rather large, but it should be borne in mind that it is the accumulation of old debts refunded and being paid by modern Uruguay although created under policies of government which today would not be tolerated. Whatever increase in national debt has been made during the past generation has been more than offset by productive properties and important public improvements. The debt of Uruguay is secured by an assignment of customs duties sufficient to guarantee interest and amortization.

At the outbreak of the European war, great uneasiness was felt with respect to the administration of public revenues since the customs duties must be seriously affected and the contracts for public improvements then under way must be carried out. The government set itself to strengthen its financial position, and offered an internal loan, first, of $4,000,000, and later of $6,000,000, to bridge the period of readjustment. This internal loan was readily absorbed in Uruguay, and, together with economies introduced by the government, and new internal taxes created to replace the losses in customs duties, brought about a prompt reaction and has

made Uruguay singularly able to take care of herself during the past two years.

A progressive country like Uruguay will, of course, need to be financed, and ought to be financed in the United States. The internal loan of $10,000,000 will be converted into a foreign loan at such time as may be deemed wise. Beyond this, the increase in public debt will be solely for the acquisition of productive properties, or the completion of important public improvements. It will be necessary to increase the capital of the Bank of the Republic, of the Mortgage Bank, which has to do with loans upon farm property, and of the Insurance Bank, which ultimately will give the government a monopoly of the insurance business. Port development must proceed, for Uruguay's chief port, Montevideo, will in the years after the war be increasingly a port of entry, through which goods will come for distribution to all bordering countries. While Uruguay is already a country of good roads, these will have to be extended and large expenditures made during the next decade. Since the franchises for electric lighting and power are entirely in the hands of the government, these must be extended, and other public utilities will, under the progressive policy of Uruguay, be acquired. Broad plans are now being made in connection with sanitation and contracts have recently been entered into looking toward full realization of these plans. Finally, the policies of the government seem to point toward ownership of railroads. Already a beginning has been made in the purchase of one short line, to be hereafter extended, and since the government is now guarantor of interest return on all railroad investments, there is a growing inclination to absorb all of the railroad properties and operate them as a government monopoly.

While the general plans of Uruguay may appear somewhat ambitious, and the program for development may occupy many years, it is a program that should be carried out, and if moderately undertaken, can be successfully financed. It is extremely important that interests in the United States keep closely informed regarding developments in Uruguay. The two countries have much in common and are in no wise competitive, in fact, in so far as the packing industry is concerned, our principal packing houses are already thoroughly established and successfully in operation in Uruguay.

Friendship to Uruguay on the part of the United States and its financial interests will involve a willingness to assist not only in financing productive improvements, but also in cautioning against a development which would too rapidly increase the tax rate of the country.

# VENEZUELA

By Francisco J. Yánes,
Assistant Director of the Pan American Union.

Venezuela is a land of unlimited yet undeveloped natural wealth, and, like all other agricultural countries, it needs capital to create or develop its natural industries.

The geographical position of Venezuela is unexcelled, as it lies in the northern portion of the South American continent, on the route to and from the Panama Canal. Its population is only about 2,800,000, while its area is about 394,000 square miles, consisting of three distinct belts or zones: the mountain belt, which separates the coast from the inland plains and plateaus, a region rich in timber and other forest products; the belt of the plains, where millions of cattle could graze and thrive; and the forest belt, a veritable storehouse of all the products of the forest, precious and dye woods, gums, resins, tonka beans, etc. The river system of Venezuela affords all the irrigation needed for the cultivation of the land, and also navigable waterways into the interior. The climate is healthful, the people hospitable, and the soil rich.

The principal products of consumption and export are coffee, cocoa, sugar, corn, cattle, rubber, hides and skins, tobacco, balata, tonka beans, gold, copper ore, iron, asphalt and heron plumes. As there are no manufacturing industries, Venezuela is compelled to import cotton goods, machinery of all kinds, agricultural implements, kerosene, drugs, canned goods, wheat flour, lard, butter, etc.

Venezuela has been called a land of revolutions, but this word does not mean the same in Venezuela as in the United States. Any movement of unrest, any mass meeting to protest against a government measure, any riot, any strike of railroad or street-car men or miners, is at once dignified by the cable or telegraphic messages by the name of revolution. It is the constant dread of these so-called revolutions and political unrest that has always prevented the entrance of foreign capital into the country, for fear of complications, loss of the money invested or lengthy and vexatious international claims, which, in the majority of cases, grow out of bad faith on the part of concession seekers.

All fear of any such danger is at present unwarranted. Peace and prosperity seem to be assured in Venezuela; its foreign and domestic debts are being paid with promptness, and foreign claims against the country have all been settled without delay. Trade has not suffered as much as was expected at the beginning of the European war, and no *moratorium* has ever been resorted to. The customs receipts, which make up the bulk of national revenues,

have notably increased, and American trade with Venezuela is now in a flourishing condition.

The peculiar topographic conditions of the country, its great area of fertile lands, its scanty population, have made certain phases of progress lag. Venezuelan railways and river shipping are prosperous, but the country needs new industries, new capital to create or develop new necessities. The present administration, among other works of real benefit to the nation, has built excellent highways for automobiles connecting some of the principal centers of production with the home markets, in order to encourage traffic and agricultural development, since railroad building, because of the character of the country, is very expensive.

The credit of Venezuela is today unimpeachable, its finances are in such excellent condition that it is one of the few countries that are not in any foreign market for a loan, and it has a surplus or reserve in gold amounting to about $50,000,000.

# MEXICO

By James J. Shirley, M. E. E.,
New York City.

Without considering present disturbed political conditions in Mexico which must be looked upon in the nature of evolutionary rather than revolutionary and which conditions will adjust themselves as all other political movements have done elsewhere—Mexico, by reason of its geographical relation to the United States, must be considered as the logical heir over all other fields for American enterprise, energy and capital.

Mexico has long enjoyed railroad advantages. There are already seven gates into Mexico along the United States border, giving access to a net of over sixteen thousand miles of modern railroad, penetrating into practically every state in the republic of Mexico—and built for the most part by American enterprise. This system of railroads enables, in normal times, an efficient intercourse between the United States and Mexico, on a scale and with a facility that no other Latin American country can ever hope to attain.

This system of transportation is all the more efficient because of the fact that 90 per cent of it is of standard gauge construction. In normal times there may be seen, almost as far south as the Guatamalan border, cars of the Canadian Pacific, Grand Trunk, Great Northern, and almost every other trunk line north of the Rio Grande. The Pullman Company operates its system throughout the republic, and normally, railroad traveling in Mexico is as rapid and comfortable as the traveling in the United States.

Taking the Canadian, American and Mexican railroad systems as a unit, what other territory of similar extent anywhere can compare in efficiency with this remarkable steel net?

### The Railroad Situation in Mexico

The railroad situation in Mexico is not generally understood. The National Railways of Mexico, comprising about eight thousand miles, are Mexican only in name. It is true the government owns a trifle over 50 per cent of the stock of said railways. The govern-

ment, however, acquired this interest in the system by issuing its direct securities in the form of bonds, and which are guaranteed as to principle and interest, not by the physical property of the railways, but by the direct obligation of the government the same as any other national security. It may be further stated, that not one of these bonds so far as known is owned in Mexico either by the government or individually. The interest on these bonds as on all other government obligations has defaulted for over three years.

Nearly every railroad in Mexico—whether National Railways or otherwise—is a physical wreck from every point of view. Stations and freight yards everywhere have been burnt, blown up and wrecked, bridges and track ruthlessly dynamited, thousands of cars and locomotives utterly destroyed and untold damage caused in every conceivable way. Why, then, it may be asked, cannot the Mexican authorities urge the bondholders of the National Railways to foreclose on the property?

This, however, cannot be done. There was embodied a clause in the railway laws covering the relation of government and railways providing that if the government should at any time take over the possession and administration of the railways (as it has actually done for military and other reasons), the properties could not be returned without an indemnification equivalent to a yearly amount based on the average returns for the previous three years of operation preceding the seizure, as well as the devolution of the property in the same physical condition it was in at the time of taking possession of it.

It happens that the three years prior to the seizure were the most prosperous in the history of the roads. The Mexican government not only has no money or means with which to repair and rehabilitate the lines, but has absolutely no credit under present conditions to pledge. For these reasons the bondholders are in the peculiar position of being able to refuse to foreclose, and yet be absolutely guaranteed against loss, provided Mexico ever reëstablishes its credit.

The representative bondholders of the National Lines are composed of syndicates whose status in international finances is such that, when the time arrives to discuss and arrange for the credit and rehabilitation of Mexico, they will have a very strong voice around the council table.

### Political Commissions Can Do Little

At this time there are commissions from the United States and Mexico in session for the purposes of first adjusting international political misunderstandings (which for the purposes of this article need not concern us) and second of devising, if possible, ways and means for the financing and rehabilitation of Mexico.

The only way that the United States as a nation can bring about the second and most important of these requirements is by pledging its credit, which in the first place would require the sanction of our legislative houses, which we can discount as being an exceedingly remote possibility.

The only alternative is to seek the help of financial interests. It can be taken for granted that no syndicate or group of bankers will consider any financing in Mexico, which will not have as a guarantee the systematic and complete rehabilitation of the National Railways of Mexico. This means, briefly, that the administration of the property must be turned over to such parties as the representative bondholders may appoint, and not to a purely Mexican administration. What the bondholders will demand, therefore, is practically a receivership without foreclosure,—the terms and conditions of which this article cannot treat.

For these and other reasons it is almost impossible to conceive of Mexico's economical problems being solved by commissions of a purely political character in which representatives of industry are not even consulted.

It is well to emphasize the fact here, that Mexico's problems are purely economic and savor but slightly of the political. Despite opinion to the contrary, there is no longer revolution in Mexico. A revolution is an internal or family war, usually between two factions, each upholding some certain principle.

### The Southern Pacific of Mexico Railroad

There is one railroad system in Mexico that is little known, which, though 1,500 miles in extent, is not at present in any way correlated with the railroad net in the rest of the republic.

This is the Southern Pacific of Mexico, extending from Nogales, Arizona to Tepic and paralleling the Gulf of California and the Pacific Ocean. This recently constructed road has opened up some of the most beautiful country on this continent, whose development

and settlement cannot remain dormant when normal conditions are reëstablished.

The west coast of Mexico as far south as Colima is literally at the foot of the Sierras and, for this reason, very little of its area is swampy or unfit for use. Little is heard of this garden spot, but acre for acre, it is no exaggeration to say, that minerally, as well as for cattle raising and farming purposes, it would be difficult to find an area as rich in potential possibilities elsewhere or a territory where as little would have to be invested to obtain a given return, as in this almost perfect sunny region, opened up by the courage, enterprise and foresight of Harriman. If one half the capital and energy were to be expended on the west coast of Mexico as there has been in California alone, the world-famed development and beauties of the latter would pale in comparison.

In conclusion it may be said that the railroad situation in Mexico is such, on account of the peculiar conditions governing it, that it offers no immediate attractions from the new investor's point of view. The possibilities on the other hand are unlimited, but it is probable that except to connect existing systems and to complete the Southern Pacific from Tepic to Guadalajara and possibly to the City of Mexico, that there will not be seen any new railroad development of importance for some years to come.

While taking account of the railroad situation, it must not be forgotten, that Mexico with its triangular shape, the apex at the south and two sides bounded respectively by the Gulf of Mexico and the Pacific Ocean, has an enormous coast line ideally situated with respect to the Atlantic, Gulf and Pacific coasts and ports of the United States. While in normal times both coasts hitherto have had excellent service not only with the United States but maybe even better with Europe, it is probable that this means of transportation will be greatly increased.

The opening of the Panama Canal has doubled and trebled the number of ships plying along the Mexican coasts—especially the Pacific. Mexico unfortunately, through no fault of its own, posseses hardly any natural harbors of commercial value, and no deep rivers. Artificial ports have, however, been constructed at enormous costs and which give ample protection and economical means of handling freight. In this respect the ports on the Gulf are not only more numerous but they are better equipped.

## Mexican Resources But Slightly Developed

Regardless of the fact that there are invested in Mexico over two billions of dollars of foreign capital, of which the United States (despite official assertions to the contrary) is second in the list of subscribers, the resources of Mexico, whether mineral, agricultural or commercial, have hardly been touched.

The oil fields of Mexico, probably the most extensive in the world, cover practically the entire Gulf region of the country. Millions of dollars have been profitably invested in this industry, and the largest individual wells in the world are here situated.

Figures of the Geological Survey prove the above assertion, and it is a remarkable fact, that though the world's output of petroleum during the last year was the greatest in the history of the industry by over twenty million barrels—and despite the abnormal conditions in Mexico, this country was, nevertheless, third on the list of producers with close to thirty-three million barrels, and this amount would have been greater if tank ships had been available. It is an interesting fact not generally known, that the British Navy has depended during this war to a great extent for its oil supplies, on the oil fields of Mexico.

Enormous as this oil area is, its development has hardly commenced. As an indication of the inexhaustible nature of its wells, it can be stated that wells in the region from Tampico to Tuxpam—some of which have been flowing for years, and are the largest in the world—are giving as great an output as when "brought in" with apparently no diminution in sight.

The California and Yukon gold rushes do not begin to compare in importance or magnitude with the wealth being produced and the development taking place, even in these turbulent times, in the Mexican oil fields. Only present disturbed conditions obscure it from more general attention and sensational notice.

## Rich Mineral Deposits

For its area, Mexico is without a doubt the richest mineral country in the world, of which gold, silver, iron, copper, lead, zinc and antimony head the long list. Its mines worked in primitive ways yielded millions since before the time of Cortez. Even now, mineral deposits without ownership are to be found throughout, which in the United States would be considered valuable, but which,

for lack of transportation facilities and because of other deposits of superior value surrounding them, at present remain unclaimed.

The immensity of Mexico's silver output hitherto can better be understood when it is realized that one-third of all the silver in the world at present in use has come from its mines. The gold production is almost as great in value. The coal and iron deposits of which latter there are literally mountains in the northern part of Mexico are exceeded probably only by the deposits in the United States and China. Mexico is truly the El Dorado of mineral wealth!

Mexico enjoys among its other attributes, every climate conceivable, from tropical to arctic due to the varied altitude of its terrain, ranging from sea level to heights of eighteen thousand feet. Is it any wonder then that within its borders are found coffee, vanilla, precious woods of every kind, fruits of every description, hemp, cotton and in fact most every product depending on varied climatic condition till the pines and the tractless regions of eternal snows are reached!

It is of interest to know that many sections of railroad in Mexico have ties of mahogany and ebony, and that miles of track are ballasted with silver ore—valuable now, but too costly to work by old processes. Houses are beamed and constructed with these precious woods and mines are similarly timbered! It is truly a nation capable of self support as no other country in the world.

## COMMERCIAL POSSIBILITIES

Pages may be written about commercial possibilities. Mexico has always imported practically every manufactured product she uses even to the majority of manufactured cotton, although she raises quantities of this staple and for some time has possessed very modern cotton factories.

In connection with cotton it is worthy of note that whereas prior to the conquest Mexico was producing nearly one hundred and twenty million pounds, since about 1882 when the industry was revived (after being completely destroyed by the Spaniards), the production has never been much in excess of fifty million pounds—an amount entirely inadequate to the needs of the country.

Food products, including such important staples as corn and wheat, have likewise always been imported in enormous quantities.

It is a remarkable fact to contemplate and which goes to emphasize the extraordinary potential possibilities of the country, that the fiscal year ended in June disclosed the fact that the trade returns between the United States and Mexico were the greatest in the history of Mexico, surpassing any previous record even during boom times preceding the present troubles.

The United States' imports from Mexico for the fiscal year were close to the colossal figure of $100,000,000, while the exports of this country to Mexico were close to $50,000,000. The figures for our imports from Mexico establish a record, but our exports were much below the average of normal times. To further accentuate these remarkable facts it is well to draw attention to the fact that the above figures on importations do not include those of the precious metals which if taken into account would further increase the remarkable record of the year.

### Military Problems

One of the greatest problems for solution—equalled in importance only by the adjustment of claims and the rehabilitation of transportation lines—is going to be the redemption of the present innumerable issues of paper currency, issued arbitrarily and in unlimited amounts. An approximate estimate is probably about $750,000,000. Mexico has reached a point of development, and its international obligations and commerce are such, that it must, for its prosperity and economical purposes, maintain a metallic basis. This metalic basis was created by law, and conditions would under no circumstances permit its abrogation. Its operation, therefore, will return with the adjustment of affairs.

The nullification of the present fiat currency should not present a very serious economic problem, for the reason that it has not (except for immediate urgent purposes) been accepted by legitimate business, and when so accepted has in most cases been almost immediately converted. Internal commerce has been almost completely paralyzed and external commerce has been at all times on a gold standard. The fiat currency has been used in most cases for military purposes, to pay off compulsory military services, military requirements and supplies, and may well be defined as "military currency."

Making a drastic statement of it, it may be said that the arbi-

trary and summary cancellation of all existing paper issues (other than bank notes which existed prior to the governmental issues of recent years) would likely work no national and probably very little personal hardship.

The justification for any step which would create as quickly as possible a metallic currency is better understood if it is borne in mind that the great majority of investments of an industrial nature in Mexico, including the railroads, have been made by foreigners and that the investment of this capital has been on a gold basis. Such of these industries as are bonded are likewise bonded on a gold basis, and the absurdity of receiving revenues in paper currency not backed metallically, and having to meet obligations and pay interest on a gold basis, is at once evident, and hence no semblance of stability can exist till this problem is successfully met. Just what form this elimination will take and by what means it can be brought about, only future developments can decide.

## European Interests in Mexico

Europe, despite its handicap of distance as compared with the United States, has consistently retained much of the commerce of Mexico which logically belongs to this country. Many reasons may be advanced to explain this. Briefly, however, the principal contributing cause has been the lack of American banking facilities as compared with those dominated by European influence. In fact no comparison can be made because there are no American banks with which to make a comparison. It can truly be said that the banking business in Mexico is entirely in the hands of Europeans. Apart from some purely local state institutions, there are no banks in Mexico capitalized, owned or conducted by Mexicans.

The great pillars of finance and credit in Mexico, such as the National Bank of Mexico and the Bank of London and Mexico, were capitalized and have always been controlled in Europe and are managed and directed by Europeans. The two leading banks of Canada, *i.e.*, the Bank of Montreal and the Canadian Bank of Commerce have each branches in Mexico. On the other hand, there is not a single American controlled banking institution doing nternational business in the whole of Mexico!

Mexico—like other Latin American countries whose initial progress has been due to European enterprise—has been accustomed

to obtain its credit in Europe in customary European ways. While present world events may tend to modify these conditions somewhat, we, as a nation, through our institutions of credit, must meet our would-be commercial partners half way, and not, as heretofore, in somewhat arbitrary style. We must, in other words, study their problems and conditions. Mexico must likewise adjust itself to the new conditions as other nations—and indeed the world at large—is doing.

A "Short Term Obligation" in Latin America prior to the war was a thing unknown. This class of obligation, however, has been found the only practical one to use by the peculiar conditions prevailing in the United States, for the reason, that the American investor has not hitherto had either the desire or the necessity to invest in foreign securities or look to foreign fields for investment, and it is not to be expected that he would take kindly to long term obligations abroad.

But even in this country we are undergoing an industrial evolution of which most of us are hardly conscious and will not realize till we waken up to find it. While isolated cases may be shown, it can truly be stated that, as a nation, we had never, up to two years ago, acted as bankers for the world. Inside of this time, however, we have loaned abroad close to a billion dollars—not a dollar of which has been other than in the form of a short term issue.

Mexico, like many other countries, is not a banker nation and has little money or capital to develop its resources, but it has the equivalent—and in almost unlimited amounts—*i.e.*, realizable assets, the foundation of sound credit.

### Plans for the Future

Great enterprises are already planned to be carried out as soon as a readjustment takes place. These include the rebuilding and building of railroads, construction of ports and harbors, erection of great irrigation systems and great commercial enterprises, including the construction of colossal hydro-electric systems, the opening up of great bodies of ore, the erection of large manufacturing enterprises of all kinds, etc.

The keynote of our successful commercial conquest, not only in Mexico but throughout Latin America, will be our willingness and ability to absorb the public securities of these countries when they are soundly created and to construct and develop the above

mentioned enterprises. Their education by Europeans has been along these lines, and we must endeavor as far as possible to follow until in the process of time we can undertake and carry on a method of our own.

In the larger undertakings involving great investments of capital, it is not compatible with the best results to encourage too much competition. Here again we can profitably learn from our European cousins. Restraint of trade should not be tolerated, but neither should cut-throat competition prevail. Circumstances alter cases, and as the foreign fields present different problems, so we should devise a different method of solution.

Such undertakings as the Trans-Andean Railroad, the Trans-Isthmian Railroad at Tehauntepec in Mexico, the sanitation and harbor improvements at Vera Cruz and the improvements being undertaken in Valparaiso, Chile, at an approximate expenditure of $15,000,000 have all been undertaken and carried out with constructive coöperation rather than with destructive competition, thereby assuring efficiency and permanency in pioneer fields.

### GENERAL CONCLUSIONS

It may, therefore, be stated in conclusion that, eliminating present political conditions in Mexico as being transitory and to be followed by a long and permanent peace, Mexico must no longer be looked upon as a country of pioneer conditions. The network of railroads covering the country from the United States border to Guatemala and the Gulf to the Pacific as well as its adequate artificial harbors, highly developed hydro-electric systems, modern municipal improvements, its splendidly and modernly equipped and operated mines and smelters for gold, silver, lead, copper, zinc, iron, etc., are all indications that the path is blazed and even paved. There is needed only the establishment of large and sound American international banks, similar to those splendid and solid British institutions found throughout South America, which are the solid foundations of British domination in commercial lines throughout the world.

The policy of such institutions, while conservative, should be judiciously liberal to meet the requirements of the situation, and should not merely furnish a medium of exchange or act as commercial "pawnshops." We must in the great development of those coun-

tries, most of which must be done primarily through coöperation with their governments, learn to absorb their securities under certain guarantees as they are issued and to create industry and improvements thereby augmenting the security as well as the revenue.

Hitherto the tendency in the United States has been to look upon the would-be investor in Latin America as an adventurer rather than as a practical business man. He is, however, far from deserving this stigma, any more than such pioneers as Harriman, Hill and others. The strength of the British Empire, as demonstrated in this present European War, is the direct result of its investments and commerce abroad. Great Britain has invested in Brazil about $750,000,000, in Argentine about $1,500,000,000, in Chile about $325,000,000, and in other countries in proportion. The mobilization of her resources during this war has clearly demonstrated the power of foreign investments when effected along sound lines.

Mexico, more than any other country, is literally beckoning us to aid her and incidentally to profit by it. Are we going to take advantage of the opportunity or are we going to let some one else usurp our right?

# RUSSIA'S FUTURE NEEDS FOR CAPITAL

By Samuel McRoberts,
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No individual or collection of individuals can undergo a great test of strength and come out of it the same as before the ordeal. If the draft upon the vitality is too great, the result is a lower order of life, or even death. On the other hand, if there is sufficient strength to successfully meet the crisis, the contest brings added physical ability and a quickened spirit. The great war in Europe has set all minds to considering the effect upon civilization, and the utility, if there is any, of war in the abstract. Whether it is an unmitigated evil, to be borne as one of the defects in human affairs, or an evil that must be endured that good may result, is a question that will continue to be debated. When we see the high civilization of England being cut down from the top, or Germany's peaceful conquest of the world abandoned for a military conquest, war takes on the aspect of disease and a menace to the constructive forces of civilization. When we turn to the case of Russia, the matter is not so clear. Dean Swift once said, in reference to his critics, that unless the asses ate off the ground leaves of certain plants, they would never grow tall, and certainly Russia has had a tendency to sprawl. Occupying one-seventh of the land of the globe, she includes a wide diversity of people, and is not entirely a homogeneous nation. National spirit has been lacking, her circulation has been slow. Individualism and personal initiative in the great mass of her population have been at a low ebb. It is idle to attribute this condition to the character of its government, for no government has failed to reflect the status of its people for any great length of time. This internal condition of Russia has been improving, very rapidly so during the last ten years, but the effects already observable seem to indicate that the war is going to accomplish for Russia within the few years of its duration what would have ordinarily required many years. Already the greatest social evil in Russia, drunkenness, has disappeared, with startling effect upon the economic and moral status of the people. The Russians are united in this titanic struggle, and a genuine

national spirit is in evidence. Old customs are being broken up, and a new experience brought to every individual in the Empire. No final judgment can be formed at this time, but it would appear that the quickening of the spirit of Russia may eventually be considered worth its terrible cost.

### RUSSIA'S PROBLEM IN FINANCING THE WAR

In 1914, at the commencement of the war, Russia had a rapidly increasing foreign trade, which produced a credit balance for meeting the service of her foreign loans. Her public debt was decreasing, and was largely offset by revenue-producing property owned by the state. Direct taxation throughout the Empire was declining year by year. The financial position was sound. The government debt, considered on a per capita basis, was the lowest of any European country, and if considered in relation to its natural resources, presented an even more favorable comparison. This advantageous financial position and the latent wealth of her resources did not save Russia, however, from the severest possible difficulties in financing the war. Internal loans were promptly forthcoming for internal needs, which were the greater part of the demands of the war, but her ports were closed and commercial intercourse with the world practically cut off. Not being able to export goods, and not owning foreign securities, Russia found herself practically without foreign resources. The unprecedented character of the war imperatively demanded huge expenditures of materials, which her own manufacturers were unable to supply, even if the raw products could be obtained within her own borders. The enormous depreciation of the rouble exchange, inevitable under these circumstances, intensified the difficulties in many ways. The situation could be met only by foreign loans. Russia and the basis of her credit were little known or understood in the United States, and therefore her requirements have been financed by England as a war measure, excepting negligible amounts furnished by this country and Japan. It thus turned out that the one country in Europe best able to stand the strain of a great war, both as regards men and natural resources, was for its immediate needs in the weakest financial position. This has all made a deep impression in Russia. What individual economists and thoughtful business men have been thinking and saying has suddenly become the conviction of the entire

country. The people are united in the purpose to develop, completely and as rapidly as possible, the natural resources of their country.

The public debt has increased from $4,500,000,000 in 1914 to about $12,000,000,000 at the present time, and the annual debt charge from $218,000,000 to about $600,000,000. These figures will continue to increase until the end of the war. Russia faces the necessity of raising immensely greater revenues than she had ever contemplated as necessary. To do this the wealth of the nation must be rapidly increased, and the ability of the individual to pay taxes, greatly augmented.

These three factors in the Russian situation—the quickening of the Russian spirit, the realization of the economic follies of the past and the importance of commercial and financial independence, and the spur of necessity—are combining to bring about a great program of development throughout the Empire. It is everywhere being discussed and advocated where thoughtful Russians congregate. It is presented in the reports of the ministers, made the topic of speeches in the Council of the Empire and the Duma, and is a recurring subject in the daily press. The government has announced that it receives almost daily from all parts of Russia, from members of the legislature, from noblemen, priests, peasants, civil service employes, officers, merchants, physicians, lawyers, workers, etc., suggestions as to how Russia should solve her financial problems after the war and that all these suggestions breathe lofty patriotism and faith in the strength and splendid future of the country. Plainly the significance of industrial development for the future of the country is felt and appreciated everywhere throughout Russia.

## The Extent and Importance of Her Natural Resources

The basis, in the way of natural resources, for Russia's economic development is very broad. The population is officially stated to be 174,000,000, the largest of any country, except China and India, with a normal increase of about 3,000,000 per year. The land area is four times the area of Europe and about three times the area of the United States and includes every variety of territory, from the highest mountain ranges to the most fertile of alluvial plains. The climate ranges from arctic to the semi-tropical of Turkestan, Trans-Caucasia and the Crimea. The country can produce within its own

area all the essentials to modern civilization. For agriculture, it has the most extensive acreage of first-class farm land anywhere found on the globe. It has about fifty per cent of the timber north of the equator. It has large known deposits of iron, manganese, coal, oil, copper, platinum, gold and silver; while minerals of lesser importance, such as asbestos, graphite, lead, mercury, salt, tin and zinc, are being produced. Eighty-five per cent of the population live in the country. The remaining 15 per cent make up the population of the cities, of which there are over two hundred in the Empire. Sixty-five of these cities have a population of over fifty thousand, and twenty-four a population in excess of one hundred thousand. One hundred and fifty-three million of the 174,000,000 inhabitants live in Russia in Europe, which in area is only one-sixth of the Empire. Twenty-one million occupy Siberia and Central Asia. Siberia, more than one-half of the Empire, has only ten million of people.

In many ways Russia, today, presents an enlarged picture of the United States at the close of the Civil War, with its population then occupying the territory east of the Mississippi River, and with a great unoccupied and undeveloped public domain lying beyond. Just as the United States then turned to the development of its public lands and mineral deposits in the West, and to the organization of industries in the East, Russia is now taking stock of her great timber resources, her fertile unoccupied lands, the hidden treasures of her mountain ranges, and turning her attention to the organization of industries in her more thickly populated sections, for only in this way can she produce the greatly increased wealth which will be necessary to enable her to meet her war obligations and give her an increasingly greater position in world affairs. The increase of grain production by the opening up of new farms and more intensive cultivation, will require capital, but not more than the surplus wealth of the present agriculture will supply. The basis for this extension is made apparent by the fact that in 1913 Russia planted to cereals alone over 215,000,000 acres. Of this, 82,600,000 acres were planted in wheat, yielding 1,024,000,000 bushels. The average yield for winter wheat was $15\frac{3}{4}$ bushels per acre, and for spring wheat $11\frac{1}{4}$ bushels per acre. This was a good year in Russia, and might be compared with the same year in the United States, when there were planted 49,601,000 acres, producing 15.2 bushels per acre, or a total of 753,000,000 bushels.

These figures demonstrate that there are ample financial resources for the extension of Russia's agriculture, such as the opening up of new territory, the improving of live-stock, the planting of orchards, the developing of fertilizers, and all those things directly incidental to a larger acreage and more scientific cultivation; but there are incidental tasks which will require large units of capital that cannot be taken directly from the agricultural community. The country has insufficient facilities for the economical transportation and storage of grain; and up to the present time the losses from this source have been on a tremendous scale. However, at the outbreak of the war the government had under way a construction-program for eighty-one elevators, of a capacity of 34,860,000 bushels; and an additional program of seventy-seven elevators, with a capacity of 37,650,000 bushels, has been agreed upon and authorized. But even as now planned, the elevator system is by no means adequate, and the whole system of grain handling and transportation will need radical reformation.

### COTTON FRUITS AND MEAT PRODUCTS

Russia today is producing in Central Asia more than two-thirds of the cotton required by Russian spindles. To grow her total requirement, and develop an export industry, necessitates the extension of the irrigated territory in Turkestan. The climate, soil and water are there, and even the engineering has been done to a large extent, so that all that will be required to make Russia independent of foreign production will be capital for the extension of an existing and successful industry. Even when this is accomplished, the need for capital will be only increased, as Russia will occupy a geographically favorable position for supplying the great cotton textile demands of Central Asia; and if sufficient cotton can be produced, there is no economic reason why her textile industry should not be correspondingly extended. This reasoning applies also to the other textiles. Today large quantities of flax and wool are exported in the raw state. To convert the export of these raw materials into manufactured products will eventually call for large expenditures.

The Crimea, the Caucasus and Turkestan are in every way adapted for the growing of all kinds of fruits, but the fruit industry cannot be extended and the products marketed without the establishment of refrigeration service, which is today practically non-

existent in Russia. This would also apply to the dairy and poultry industries of Siberia. The raising of food animals is an important activity throughout the Empire; and Russia has more sheep and goats than the United States, nearly as many cattle, and about one-fourth as many hogs. Recently much attention is being given to scientific breeding, and some progress has been made in feeding for food results, but there is no organization of the industry beyond the farms. Australia can put mutton on the market in Russia cheaper than the home-grown product can be obtained, because in Russia all animals are sent as live freight to the point of slaughter; the economies from centralized slaughtering plants and the handling of the dressed product under cold storage having not been yet introduced.

## OPPORTUNITIES IN LUMBERING AND MINING

Russia is practically the only country in Europe having an excess of timber over and above its own requirements. While Sweden, Norway and Austria-Hungary still have a surplus; of recent years it has become so small as to be almost negligible. Russia is the great timber reserve of Europe, and while in 1913 she exported timber to the amount of $84,000,000, she still has not begun to realize upon the possibilities in her timber trade. The Englishman's definition to the effect that timber was "an excrescence growing upon the earth, chiefly useful for paying off the debts of one's ancestors," will be particularly applicable to the Russian forests. The demand for timber in Europe following the war must necessarily be greatly in excess of normal. It is stated that after the earthquake in Messina, in 1913, Italy's timber import increased 22 per cent over the average for the previous five years. If this is any indication, Russia will have a wonderful opportunity to realize the latent wealth of its forests. This will mean an enormous outlay of capital for the building of railroads, port facilities, steamships, sawmills, pulp mills, and all of those things incidental to the manufacture and transportation of timber products.

Russia has already taken steps to attract foreign capital to the mining industry, by reforming its taxation laws and granting more liberal concessions, and by facilitating, as well as granting government aid to, the importation of improved mining machinery. She will necessarily continue to stimulate in every way the production

of gold and the other precious metals. Her known copper deposits make her practically independent of international production, and the best authorities agree that her mineral fields have not begun to be exploited.

## The Need for More Railways

One of the chief essentials underlying the whole problem of economic progress and realization of national energy and labor is the expansion of the railway net of Russia. An adequate railway system is absolutely indispensable for bringing out the natural resources of any country, and the extension of the railway system of Russia cannot be economically accomplished without a full development of her metallurgic industries. Even before the war there was a growing feeling in Russia that her railway system was not commensurate to the economic needs of the country; and since that time this has become too self-evident to be questioned. The total railroad mileage in Russia is 47,000 miles. An idea of what this means, in the way of unserved territory, can be obtained by comparing it to the railway mileage of the United States, which country, while only one-third as large, has 260,000 miles of road. This means that Russia, on the basis of square miles, has only 5 per cent, and on the basis of population, only 10 per cent, of the railway mileage of the United States. This has been fully discussed, and its importance understood, in Russia; and it seems to be considered as the initial problem to confront the country at the close of the war. The government commission has already examined and sanctioned the building of a total of 16,776 versts, at an estimated cost of 1,466,000,000 roubles, and at the beginning of the present year this program was further enlarged by the sanctioning of an additional 3,000 versts, at a cost of 266,000,000 roubles. So the country is already officially pledged to the construction of about 20,000 versts, or 13,333 miles, while projects are under consideration for official action that will bring this up to about 17,000 miles, at an estimated cost of over a billion dollars.

It is the declared purpose of the government, provided capital can be obtained from the international money markets, to enter upon a policy of construction that would produce approximately 5,000 miles per year. It is highly improbable that any such extensive program can be carried out, with the result that only those

projects presenting the most attractive opportunities to capital will be taken up. What this means to the steel industry in Russia is apparent when we consider that each mile of road requires approximately two hundred tons of metal. Furthermore, the existing railroads, while well constructed, are designed to bear only a light unit of transportation. With long hauls and heavy traffic, Russia is being forced to the large unit of transportation adopted in this country, which will require re-laying the existing roads with heavier rails and the strengthening of all right-of-way structures. It will be prohibitively expensive for Russia to import railway metal, owing to the high cost of transportation, therefore the pace of her railway development will be determined not only by the readiness with which capital is obtained, but by the extent and speed of the enlargement of the steel industry. The country is fairly well supplied with coal, and it has iron ore in very great abundance. At the present time the development of both coal and iron is by unrelated and comparatively small units; adequate and economical results will not be obtained until the whole industry is organized along comprehensive lines and the raw materials linked together by special transportation facilities.

### The Steel and Coal Industries

In addition to soft coal, which Russia is seeking to conserve for the steel industry, the largest anthracite deposits in Europe are located in European Russia. The production of anthracite has been comparatively small. During the year ending July, 1914, the output was only about five million tons, although there was a shortage of fuel at Moscow, but 650 miles distant. The production of these coal fields has been by one-shaft mines, by small companies. There is no resident mining population, the work being done almost entirely by farmers coming to the mines at the season of the year when they are not employed upon their farms. As a result the cost of producing anthracite is about twice what it is in this country. The government has recently adopted the policy of conserving soft coal for the steel industries, and to that end has made regulations requiring the use of anthracite for all industrial boilers and railroads, after a certain date. This will greatly stimulate the use of anthracite and necessitate the placing of the mining upon a more comprehensive and economical basis.

The foregoing are simply isolated illustrations of the needs for capital in Russia. There are other important ones, such as hydroelectric development, municipal and interurban transportation, harbor works, canals and ship-building, and possibly still more important is the additional general working capital necessary to finance the incidental commerce and trade that is a part of a great progressive movement.

### The New Russia

Whether this program of industrial development will be undertaken or carried out, of course, depends primarily upon the temperament and capacity of the Russians themselves. It might be said that, being to some extent Oriental, they do not have the same attitude towards business as do Americans or other Europeans; that the status of the laws, their adherence to communal practices, and the restrictions upon individual activity, will be insurmountable barriers. This is not borne out by observation in Russia under the present conditions. They are a far-North people, and have the characteristic vigor and activity of all European races. They are breaking up community of ownership and getting away from the socialistic doctrines that we in this country are reacting to from a too intense individualism. While the citizens of all countries are very much prone to look upon themselves as different from, and incidentally better than, the people of other lands, the real fact remains that all peoples are essentially the same and respond in similar manner to physical and ethical influences. The conditions in Russia are much the same as those that preceded the great industrial rise in this country, and for the same reasons that it occurred here, we may confidently expect an era of individualism and materialism to be inaugurated in Russia.

# CANADIAN CAPITAL REQUIREMENTS

By O. D. Skelton,

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With half a continent held in trust, its resources little known and less developed, Canada must for many a year be a seeker of capital. In the past fifteen years it has absorbed four or five billions in railroad construction, in developing mine, forest and farm, in securing adequate manufacturing equipment, and in the municipal expansion required to serve the needs of the rapidly growing cities. Today, in addition to a more moderate rate of expenditure upon these objects, the Dominion has to meet its heavy share of the cost of a great war, and to finance the munitions manufacturing which has taken first place among its industries. Tomorrow, the need will continue for capital, to fund the short-term borrowings of the war period, to finance the railway reorganization which is inevitable, and to continue the normal industrial development.

In the past, Canada sought the capital required from three sources—the United Kingdom, the United States and in the Dominion itself. French, Dutch and German investors supplied a steadily increasing amount of capital before the war, but it made up a very small fraction of the whole. It is in the English-speaking world that Canada has found her capital in the past and must for the most part find it in the future.

## Growth of Canadian Borrowing

Until the war, the United Kingdom was Canada's chief banker. The interest of British investors in Canada had been a comparatively recent development. It is true that it was largely British capital which built the Grand Trunk and to a less extent the Canadian Pacific, that many an early Canadian mining venture found trusting investors in London, and that the federal and the provincial governments went to the same market for their borrowings. Yet until 1900 the total thus borrowed was not great. The United States Australia and the Argentine far outranked Canada in British favor.

Then came the opening of the West, the newly quickened confidence of Canadians themselves in their own country, and the immigration of hundreds of thousands of United States farmers. The enthusiasm proved contagious, and British purse strings were loosened, until Canada took first place among Britain's outside fields of investment. At the end of 1910, according to the London stock exchange totals, compiled by the *Economist*, Canada had outranked all other parts of the Empire, attaining a total of £365,000,000;[1] the three and a half years which followed, to the outbreak of the war, added £190,000,000 to this amount. In 1913 these borrowings reached their maximum. In that year, according to *The Statist's* compilation, Canadian flotations in London amounted to £47,000,000 out of a total of £245,000,000 capital subscriptions made in the United Kingdom, or nearly one-fifth of the whole. This movement continued to the very eve of the war: in the first six months of 1914 over £37,000,000 British capital found the same outlet. Including capital not listed on the London exchange, the total amount of Canadian borrowings from Britain was estimated at this time, by Sir Frederick Williams-Taylor of the Bank of Montreal, to be approximately $2,500,000,000.

The chief rôle of the British investor has been to finance the constructions of the two new transcontinental railways, either by direct loan, or by loan to the governments which built or subsidized them or guaranteed their bonds. A surprisingly small, if latterly increasing, fraction of the British capital went into industrial development.

### UNITED STATES INVESTMENTS IN CANADA

With the United States, the case was quite otherwise. The total amount of American capital invested before the war was only about one-fourth of the British supply. To a still greater extent than in the case of the United Kingdom this investment was a very

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[1] LONDON STOCK EXCHANGE OFFICIAL LIST, DEC. 28, 1910

(*Mining and Rubber Flotations as Given in Mathieson's Lists*)

| | |
|---|---|
| Dominion of Canada | £365,368,800 |
| India and Ceylon | 350,758,200 |
| Australasia | 327,000,600 |
| South Africa | 256,603,200 |
| Other parts of the British Empire | 102,827,800 |
| | £1,402,558,600 |

recent development. The distinguishing feature, however, was the preference of American investors for industrial rather than railroad or government issues. In other words, the United States investor was seeking profits, the British investor interest. The United States investor put his money into factories, timber limits, mines, land deals, keeping control, taking the risks and taking the profits or losses. The British investor bought the bonds of the governments or of railways controlled (except, to a lessening extent, the Grand Trunk) in Canada.

Careful, detailed and authoritative summaries of United States investments in Canada have been compiled by Fred W. Field, for the *Monetary Times*. These estimates show how recent and rapid has been the growth of American interest in Canadian opportunities. The latest estimate, given in somewhat greater detail, shows the overwhelming industrial and speculative character of these investments, up to 1914.

ESTIMATE OF UNITED STATES INVESTMENTS IN CANADA
(*Monetary Times Annual, 1914*)

| | |
|---|---|
| 1909 | $279,075,000 |
| 1911 | 417,143,221 |
| 1913 | 636,903,952 |

Following is a summary of United States investments in Canada in 1913:

SUMMARY OF UNITED STATES INVESTMENTS IN CANADA, 1913

| | |
|---|---|
| 450 branch companies, with average investment of $300,000 | $135,000,000 |
| Investments in British Columbia mills and timber | 70,000,000 |
| Investments in British Columbia mines | 62,000,000 |
| Land deals in prairie provinces | 40,000,000 |
| Investments in lumber and mines, prairie provinces | 10,500,000 |
| Theatrical enterprises | 3,000,000 |
| Packing plants | 6,750,000 |
| Agricultural implements distributing houses | 9,255,000 |
| Land deals, British Columbia | 60,000,000 |
| Investments of United States life and fire insurance companies | 67,831,497 |
| Miscellaneous industrial investments | 12,225,000 |
| Purchase of city and town property | 20,725,000 |
| Investments in the Maritime Provinces | 13,125,000 |
| Fox farm investments, Prince Edward Island | 1,000,000 |
| Purchase of government, municipal and corporation bonds, 1905–1913 | 123,742,455 |
| Total | $636,903,952 |

Especially significant is the list of branch manufacturing establishments, covering agricultural implements, motor-cars, typewriters, hardware, scales, cash registers, brass goods, cereals, tobacco and scores of other commodities. Usually these establishments began as distributing or assembling branches, and later expanded into full-fledged factories

### FOREIGN TRADE OF CANADA

In connection with the capital investments of the United Kingdom and the United States, in Canada, it is important to recall the Dominion's trade relations with the same countries. In brief, Canada found its chief market in the United Kingdom, and did its buying chiefly in the United States. In the last fiscal year before the war, the year ending March 31, 1914, the United Kingdom took 50 per cent of Canadian exports, the United States 37 per cent and other countries 13 per cent. Of the imports of Canada, on the other hand, the United Kingdom provided only 21 per cent, the United States 64 per cent and other countries 15 per cent. The figures for the preceding decade reveal substantially the same relations.

| | IMPORTS OF CANADA FOR HOME CONSUMPTION (*In millions of dollars*) | | | | EXPORTS OF MERCHANDISE, THE PRODUCE OF CANADA (*In millions of dollars*) | | | |
|---|---|---|---|---|---|---|---|---|
| Fiscal Year | From—U.K. | U.S. | Other Countries | Total | To—U.K. | U.S. | Other Countries | Total |
| 1905 | 60 | 152 | 39 | 251 | 97 | 70 | 23 | 190 |
| 1906 | 69 | 169 | 45 | 283 | 127 | 84 | 24 | 235 |
| 1907 (9 mos.) | 64 | 148 | 37 | 249 | 99 | 62 | 19 | 180 |
| 1908 | 94 | 204 | 53 | 351 | 126 | 91 | 30 | 247 |
| 1909 | 71 | 170 | 47 | 288 | 126 | 85 | 31 | 242 |
| 1910 | 95 | 217 | 57 | 369 | 139 | 104 | 36 | 279 |
| 1911 | 110 | 275 | 67 | 452 | 132 | 104 | 38 | 274 |
| 1912 | 117 | 330 | 74 | 521 | 147 | 102 | 41 | 290 |
| 1913 | 139 | 436 | 95 | 670 | 170 | 139 | 46 | 355 |
| 1914 | 132 | 395 | 91 | 618 | 215 | 163 | 53 | 431 |

In 1913, for example, Canada bought goods from the United Kingdom to only half the amount of the capital she borrowed, while she bought from the United States probably four times as much as she borrowed. In other words, Canada borrowed her capital in the United Kingdom and used it to make her purchases in the United States. In spite of Canada's tariff preference to Great

Britain, of their close political relations, and of the fact of the furnishing of the capital itself, the mother country secured less than a third as much of Canada's trade as did the United States.[2]

The third source of capital before the war was the Dominion itself. In spite of its small population, of the lack of accumulated capital, and of the absence of European habits of thrift, the Dominion was able to provide the bulk of the money needed for the ordinary commercial and industrial undertakings of the country. The discounts of the chartered banks, which obtain their capital almost wholly within the country, rose rapidly from $279,000,000 in 1900 to $1,111,000,000 in 1913. Between the census years of 1901 and 1911 the capital employed in manufacturing grew from $353,000,000 to $1,247,000,000, 90 per cent of it provided in the Dominion itself. The capital required for railway building, however, and for government purposes, came for the greater part from without. Municipal debentures alone found an important share of their takers in Canada.

### Increased Borrowing During the War

This was, in brief, the capital situation at the outbreak of the war in August, 1914. At first it was believed that with the war there would come an almost entire cessation of borrowings. The reaction after the boom period of 1900–1912 had already brought a halt in industrial expansion and in the land speculation which accompanied it. London was beginning to tighten its purse strings. The needs of the war, it was felt, would absorb all surplus British capital. Canada would have to cut its coat to suit its smaller cloth.

These expectations, natural as they were, were not borne out by facts. The issue of Canadian bonds never reached as high a total as in 1915, and 1916 bids fair to record a higher level. Railway construction, it is true, fell off with the approaching completion of the great trunk lines, and municipalities slackened in their programmes of road and sewer and power plant construction. Yet a steady flow of municipal securities has been maintained, the provinces have borrowed more extensively than usual, the Dominion

[2] For interesting summaries of the relation between Canada's borrowing and her foreign trade, see the article by Dr. James Bonar on "Canada's Balance of Trade," *Proceedings Canadian Political Science Association, 1913*, and the analysis by R. H. Coats in the *Report of the Cost of Living Commission, 1915.*

has found it necessary and possible to float one large loan after another to meet its internal and its war requirements, and a small amount of railway and industrial issues has been placed.

The United Kingdom, as was expected, found it necessary to confine its capital resources to war purposes. No Canadian issues were made in London in 1914, after the outbreak of the war. In 1915, two railway loans were sanctioned, note issues of the Grand Trunk and Canadian Northern amounting to $16,175,000. In March of the same year the Dominion government made its first and only public sale of bonds in London since the war, $25,000,000 in five- and ten-year bonds at 4½ per cent; the issue was largely oversubscribed. This completes the list of public issues in over two years. No provincial, municipal or industrial bonds have been sold in London in that time.

The United Kingdom, however, did, at first, aid substantially in providing for the war expenditure of the Dominion. From September, 1914, to July, 1915, $10,000,000 a month was advanced by the British to the Canadian government, some $100,000,000 in all. Since that time the Dominion has been able to meet its share of the war expenditure out of its own resources, so far as that greater part of it which takes place in Canada itself, is concerned—including separation and part pay allowances, and amounting to perhaps three-quarters of the million dollars a day that the war is costing Canada. The expenditure on the Canadian forces in Great Britain and at the front is still provided for by borrowings from the British treasury. Arrangements have recently been made for funding these temporary advances. The Canadian government is issuing to the British government dollar bonds bearing the same rate of interest as the British government is required to pay on the loans from which it made the advances. The hundred millions advanced in the first year of the war are met by the issue of dollar bonds maturing in 1928 and 1945, and bearing 3½ and 4½ per cent interest. These bonds are not being sold by the British treasury, but are used as collateral to assist its purchases of munitions and supplies in the United States and Canada. Offsetting these loans by Britain to Canada, there have been heavy loans by Canada to Britain; the Canadian chartered banks have financed the great bulk of the purchases made here by the Imperial Munitions Board.

With the British market thus cut off except for war loans, it

became necessary to find new resources. The striking features of the war period have been, first, the rapid expansion of United States investments in Canada, and second, the discovery by the Canadian people of their own financial resources.

### Loans Floated in the United States

During the first two years of the war, Canada's borrowings in the United States slightly exceeded $300,000,000. The Dominion government has been the largest borrower. In July, 1915, it issued in New York $25,000,000, 5 per cent one-year notes, and $20,000,000 two-year notes, both convertible into 5 per cent twenty-year bonds: the first loan was repaid on maturity in August last. In March, 1916, a loan of $75,000,000 in five-, ten- and fifteen-year bonds was made in the same market, at a price to yield on the average 5.36 per cent to the investor. The reception given this issue was such as to justify the comment of Sir Frederick Williams-Taylor, that, "no other foreign country in the world could borrow on such favourable terms in the United States."

It was not, however, only the Dominion which now for the first time has turned to the United States for capital. In the two years of war the provinces have borrowed $55,000,000 and the municipalities $60,000,000 in the United States. In 1915 every one of the nine provinces except Prince Edward Island floated a New York loan. The municipal debentures were issued in large part through bond houses in Boston, Chicago, Cleveland and other centers. In addition, corporation issues, chiefly railway and public utility bonds and notes, were placed to the amount of $66,000,000.[3]

In this connection, the outstanding facts as to the changes in trade relations may be reviewed. Canadian imports have fallen off slightly since 1913, though this present year bids fair to exceed all previous records. The falling off was chiefly in the imports from

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[3] Canadian Borrowings in the United States, Aug. 1914–Aug. 1916.

(*Monetary Times Record*)

| | 1914 (Aug. 4 to Dec. 31) | 1915 (Jan.–Dec.) | 1916 (Jan. 1–Aug. 1) |
|---|---|---|---|
| Dominion government | | $45,000,000 | $75,000,000 |
| Provincial governments | $1,000,000 | 35,877,000 | 18,450,000 |
| Municipal | 6,900,000 | 32,455,000 | 20,763,000 |
| Corporations | 18,690,000 | 30,640,000 | 17,022,000 |
| Total | $26,590,000 | $143,972,000 | $131,235,000 |

the United Kingdom, and from the other belligerents, both allies and enemies. The imports from the United States decreased slightly at the outset, but are now larger than ever, amounting to five times the importations from the United Kingdom. Canada is still, as she was before the war, the third best customer of the United States, the only difference being that France has displaced Germany as the second largest. It is interesting to note that this past year Canada took more United States goods than all Asia and South America combined.[4]

### ENORMOUS INCREASE IN CANADIAN EXPORTS

While imports, to the surprise of most observers, have thus maintained practically their old levels, exports have followed a still more surprising course. In spite of the fact that 350,000 men have been withdrawn from their ordinary occupations, the production of wealth has been maintained and exports tremendously increased, more than doubling in the past three years. Much of this increase, of course, is nominal, reflecting higher prices, and a large part of the manufacturing exports consist of munitions and other temporary war supplies, but the figures of exports of forest, field, and mine show the country's permanent possibilities.[5] The figures for the first few months of the fiscal year 1916–17 show still more rapid growth. Of last year's $741,000,000, the United Kingdom took $463,000,000 and the United States $320,000,000, as compared

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[4] UNITED STATES EXPORTS (FISCAL YEARS ENDING JUNE 30)

(*In millions of dollars*)

| | 1914 | 1916 |
|---|---|---|
| United Kingdom | 594 | 1,518 |
| Germany | 344.79 | .2 |
| Canada | 344.71 | 466 |
| France | 159 | 630 |
| Asia | 113 | 278 |
| South America | 124 | 180 |

[5] EXPORTS OF CANADIAN PRODUCE (EXCLUDING COIN AND BULLION, AND REËXPORTS)

(*Fiscal years ending March 31, in millions*)

| Year | Mine | Fisheries | Forest | Animal produce | Agricultural produce | Manufactures | Miscellaneous | Total |
|---|---|---|---|---|---|---|---|---|
| 1913 | 57 | 16 | 43 | 44 | 150 | 43 | .. | 355 |
| 1916 | 66 | 22 | 51 | 102 | 249 | 242 | 6 | 741 |

with $177,000,000 and $167,000,000 respectively three years previous. The United Kingdom bought from us nearly six times as much as it sold us: the United States bought about 75 per cent as much as it sold us. When it is considered that three years ago the United States bought only about 40 per cent as much as it sold, the surprising fact appears that just in the period when the investments of United States capital have been growing most rapidly, the excess of United States exports to Canada over imports has been decreasing. The explanation of this paradox is found in the changed relations of both countries with the third factor in the settling of our international balances, the United Kingdom.

## Large Loans Floated at Home

The other source of Canadian capital has been the Dominion itself. Not only have the banks continued to finance the ordinary commercial needs of the country and in addition aided the establishment of large war supplies industries, but a considerable share of the municipal issues of the two years has been absorbed in Canada and two war loans of $100,000,000 each have now been taken up. The first Dominion loan was issued in November, 1915, and netted 5.48 per cent to the investor; the second, in September, 1916, nets him 5.30 per cent—a significant index of the maintenance of Canadian credit and of popular confidence. It has taken war exigencies to reveal to the people the efficiency and flexibility of their banks and other credit mechanism, and to stimulate saving. It cannot be said that there is as yet a great increase in thrift and economy; some improvement is observable, but on the whole the prosperity of the country has been too great and the proportion of direct taxes imposed too small to necessitate any startling change in our habits of living. Not that new taxes have not been imposed; federal, provincial and municipal authorities alike have prudently made provision for meeting a share of any increased war-time outlay out of current revenue. The Dominion has raised tariff and excise duties, imposed small stamp taxes, and levied a tax on war-time profits, and at the same time ordinary expenditures have somewhat lessened, with the result that there has been a substantial surplus to apply to war financing. In the present fiscal year, at the present rate of income and of outgo, after paying all ordinary and capital expenditures and meeting the interest on the previous

war loans, there will probably be a surplus of forty or fifty millions to apply to the principal of the war expenditure The amount of the federal revenue is thus very satisfactory, though there is room for criticism in the small, though increasing, proportion of it levied by direct taxation.

The success of the domestic loan issued in September, 1916, has given proof of the extent of the resourses which are now being tapped for the first time. The $100,000,000 offered was more than twice subscribed. The $50,000,000 subscribed by the chartered banks was not accepted, but was instead advanced to the British government as the basis for futher purchases of supplies in Canada.

## FUTURE NEEDS

After the war, the United Kingdom will once more be prepared to finance colonial and foreign enterprises, though on a smaller scale. It is probable, however, that so far as Canada is concerned, the war-time tendency to rely more on United States and on home financing will continue. The Dominion is finding itself. The extent of its resources has long been known or guessed. In the past decade it acquired in great part the railway, factory, municipal plant required for their development. During the war it is attaining an efficiency in organization, a confidence in its own possibilities, and a variety and independence in capital resources not enjoyed before. The United States, meanwhile, has been growing immensely in wealth and in credit facilities. It seems certain that a large part of the surplus capital of the United States will continue to find investment on a large scale in the country which, in virgin opportunities, in soundness of financial and government conditions, in similarity of commercial methods, in the extent of trade relations, and in the opportunity for personal investigation which its geographical closeness offers, has the strongest appeal to the American investor.

# THE FUTURE OF PUBLIC UTILITY INVESTMENTS

By Delos F. Wilcox,
Franchise Expert, New York City.

The expansion of public utilities and the enormous increase in public utility investments during the past twenty-five years have been among the most remarkable economic developments of a remarkable period in the nation's history. Street railways, electric light and power plants and telephone systems have multiplied in number and increased in size out of all proportion even to the rapid increase of urban population during this period. The development of gas plants has been more steady, but water works, representing for the major part municipal investments, have necessarily developed with great rapidity, since the growth of cities, and especially their crowding together in the more densely populated sections of the country, increases both the relative difficulty and the relative expense of securing adequate water supplies. In attempting to forecast the developments of the next ten, twenty or thirty years, we are met by many uncertainties. Assumptions must be made. The easiest ones to make are that the increase of the total population and the relative increase of the urban population will continue in the future to go along as they have in the immediate past and that the development of public regulatory policies will hold the even tenor of its way, regardless of war's alarms and the expected truculencies of the new breed of powder-and-shell millionaires created by the war. These are rather violent assumptions, but for the purpose of this discussion I shall make them, with the hope that any conclusions reached may be subject to easy modification by other people who think themselves in a position to make different and wiser hypotheses.

## Extent and Causes of Utility Investments

The total nominal investment at the present time in what are ordinarily described as public utilities, in which I include street and interurban railways, artificial and natural gas plants and pipe lines, electric light and power systems, including water power developments, local and long-distance telephones, water works, central

heating plants, electrical conduits, etc., must be about twelve billion dollars. The average annual increase in these investments during the past decade must have been about five hundred million dollars. How much of the grand total and of its annual increments is inflation, nobody knows. But in the city of New York alone, the actual investments in water works and rapid transit lines during the decade from 1907 to 1917 will have been more than half a billion dollars, to say nothing of the additional investments in surface street railways, lighting plants, telephones, etc. Upon the assumptions already made, it seems safe to estimate that the demand for additional capital for public utilities in this country will continue to be about half a billion dollars a year; it may be considerably more.

The fundamental causes which have hitherto brought about the rapid increase in public utility investments may be briefly analyzed. Public utilities are urban phenomena; they are the instruments by which the economic advantages of city life are multiplied and its disadvantages lessened or removed. Their development up to the full realization of their economic value under the prevailing conditions of human knowledge and skill is inevitable. It is readily observed that the larger an urban community becomes, the more dependent are its inhabitants upon public utility services. Furthermore, in the case of the leading utility, transportation, along with this increasing dependence goes the necessity for a larger *quantity* of service per capita. This is well illustrated in the development of urban transit in New York. Over a period of fifty years the number of street railway fares annually paid per capita increa ed from 43 in 1860 to 321 in 1910. Even after the electric trolley system had been fully developed, the increase for the decade from 1900 to 1910 was 75 rides per capita, or more than 30 per cent. Moreover, in a rapidly growing community, public utility investments tend to lag behind the demand for them and therefore, even when a city's growth slackens or stops entirely, the demand for public utility expansion still continues until the community has spread itself out, provided itself with all the necessary conveniences of modern life and settled down into a static condition.

Just so long as the population of a city continues to press out into outlying districts or to shift from one district to another, even though there may be no actual increase in the aggregate number of

people or in the quantity of utility service required, new investments will be necessary; since existing investments in pipes, wires, tracks and other street fixtures cannot readily be moved from one place to another to follow the shifting population. We may revert again to New York for an illustration. Here through a long period of years the old city grew to the north, developing the superlative congestion that has come to be characteristic of Manhattan Island. Within the period of fifteen years from 1904 to 1919, the number of continuous transit tracks crossing the East River by bridge or tunnel will have increased from four to thirty-eight, with the inevitable result that a great shifting of population from the crowded districts of Manhattan Island to the nearby but hitherto sparsely settled districts of Long Island will take place. If we assume no total increase in the population of the city, this transfer from one section to others, without releasing any of the existing public utility investments required for the service of the old congested district, will necessitate large additional investments in the new districts.

## Other Reasons for Expansion

A further increase in the demand for utility services comes as a result of the general advance in the arts and the general rise in the standards of living of the people, both of which are concomitants of a developing civilization. I may cite as illustrations the effect of modern plumbing upon the amount of water used and the increase in the use of gas and electricity for heat and power as a result of the installation of modern appliances for lessening the drudgery of housekeeping. But even more important in its effect upon the development of public utilities is the increasing use of gas and electric current for power in connection with the processes of industrial life. Another reason for the expansion of public utility investments is the more complex organization of social and industrial life, which is largely the result of improved facilities for transportation and communication and which in turn necessitates a continual increase in these facilities. It seems obvious that the relative importance of transportation and communication necessarily increases with the growing complexity of social organization. This is particularly true of the telephone as a primary means of communication for social and business purposes, and of course applies with equal or

greater force to facilities for the transportation of food products and other commodities. But these latter facilities are primarily furnished by the railroads of the country and do not fall within the class of public utilities as here defined except to a limited extent in connection with suburban and interurban railways.

There still remain to be considered two important factors in the expansion of public utility investments. I have referred to public utilities as urban phenomena, yet the fact is that the characteristics of urban life are fast becoming the characteristics of life throughout the country. In other words, the surburban and rural districts are rapidly becoming urbanized and the extension of public utility services beyond the limits of urban communities is the essential means by which this process is being carried on. It is the telephone, the trolley, the electric light and running water that herald the advance of urban civilization and comfort into the rural districts. Indeed we might properly refer to these utilities as the promoters or sales agents of the economic and social advantages hitherto characteristic of urban life. This territorial expansion of utility services means generally an even greater investment in proportion to the population served than the investment required for strictly urban service. The other factor to which I wish to call attention is the development of natural resources as the basis for these public utility services. It has been only a comparatively few years since water power became an important element in the electrical industry, and the development of water power is believed to be still in its infancy. The whole problem of the conservation and development of these natural resources, though it is regarded as in large measure, if not primarily, a problem of the federal government, is in effect a municipal problem, namely, how best to bring to the people in their urban communities the resources which nature has provided in the wilderness. The same is true of the development of natural gas fields and the construction of interstate and intercity pipe lines. But while water power is as everlasting as climate, there is great uncertainty as to the time when the reservoirs of natural gas hidden away in the bowels of the earth will become exhausted. Therefore, it would be unsafe to make any prediction as to the probable demands for additional capital in the development of the natural gas supply and its transmission to the urban communities where it can be used.

### Enormous Speculative Gains

Up to the last few years, public utility investments were regarded as properly speculative. It is hard now to realize how valuable a street car franchise in a great city was supposed to be in the last two decades of the nineteenth century, the period during which the Broadway franchise was bribed through the New York City board of aldermen and the inverted pyramid of the Metropolitan Street Railway system was formed. A perpetual franchise on Manhattan Island was supposed to be an inexhaustible gold mine. Many of the large fortunes built up in different parts of the country were the direct results of the manipulation of public utility securities and the sale of public utility franchises that had been acquired for a song. By men of substance it was regarded as perfectly proper, and by the common rabble as almost so, for the owners of a public utility to take millions out of it. Competitive franchises were granted in the vague and vain hope on the part of the public that thereby monopoly would be scotched, service improved, public revenues increased and in some cases rates reduced. These competing franchises were sought with fair promises on the lips of the promoters, but with greedy purposes in their hearts. They were sought chiefly for the purpose of being sold at the Blackmailers' Auction. Fixed rates, monopoly privileges, universal necessity and rapidly increasing urban population, made promoters willing to accept short-term franchises where they could not get long-term or perpetual ones and to invest enormous sums of other people's money in plants whose status at the expiration of the franchises was wholly unsecured except by the necessity that the service be continued and by the hope that renewals could be had at the same public bargain counter where the originals had been procured. While it is probable that more fortunes have been made out of street railway franchises than out of any other kind, speculation and profit-taking were by no means confined to this utility. In the early days gas and water franchises and later electric light and telephone grants were involved in the same riot of speculation.

### Taxation Only a Partial Remedy

The first attack upon franchise privileges was by means of increased taxation, on the theory that the public, having contributed the rights of way for the tracks, pipes, wires and conduits,

ought to have a larger share in the profits. Unquestionably taxation, in so far as it takes new forms and becomes more drastic, will have the effect of decreasing the profits of the utility owners and thereby of reducing the value of their franchises without giving any direct relief to the consumers. The amount of actual capital invested in public utilities is not directly affected one way or the other by taxation, but as long as franchise and other intangible values make up a large part of the backing for utility securities and represent a large share of the so-called "investment," taxation, and still more taxation, will have a tendency to reduce or destroy these intangible values and knock the props out from under the securities. The copiousness and continuity of the stream of gold that pours into the lap of a public utility makes it a shining mark for the tax gatherer, with the result that in spite of the tremendous political power of the utility owners, they have been compelled more and more to submit to additional exactions in the form of higher assessments and special taxes, until at the present time their groanings assault the ears of every official who has anything to do directly or remotely with taxation or the control of public utilities. It is evident, however, that unless public utility rates are irrevocably fixed, the burdens of taxation, after it has destroyed intangible values, and often before that time if the utility managers are strong and cunning, will be shifted to the patrons of the utility in the form of higher rates or poorer service.

## RATE REGULATION MORE EFFECTIVE

When division of profits through the instrumentality of taxation had been tried for a while, the public began to attack the problem more directly through rate regulation. The rate payers revolted against being exploited for the relief of the taxpayers. When the theory of the regulation of rates and services by means of permanent local or state commissions came into vogue, it struck a body blow at the philosophy of speculation in utility investments, but however bankrupt their philosophy became, the owners of utility securities were impelled by all the primary incentives of self-preservation to resist step by step to the bitter end the encroachments of the state upon their privileges. It is the theory of rate regulation that the investment in a public utility is affected with a public interest and that the owners of the utility are entitled to earn

a fair rate of return and no more upon their capital prudently and usefully invested in the public service. This theory, if consistently and unflinchingly applied, would eliminate most of the speculative element in utility investments and reduce them to an approximate parity with municipal investments, where the security is nearly perfect and the rate of return is low.

### THE PRESENT CONTEST OF VITAL SIGNIFICANCE

We are now in a transition stage, striving to put into effect this new theory and being met at every stage by the strong entrenchments of vested privilege. It is still too early to determine the outcome of this great war. If democracy, overflowing the land, gradually isolates and smothers the citadels of privilege and succeeds in establishing the theory that public utilities shall be operated as public business, and public utility investments shall be secure and by virtue of such security low-paid, we may at least expect that the conquered will react upon and modify the character of the conquerors. The great struggle now going on throughout the United States is to establish the recognized value of public utility and railroad investments. The owners are driving hard for the legal recognition of enormous values based upon physical structures supplemented by ancient privileges and fertile imaginations. They are doing their best to embalm the fat carcasses of old speculations lest they be decomposed and pass to final dissolution. They say that regulation and scientific franchise principles are all right for the future, but for the Lord's sake, do not disturb the past; well knowing that unless we succeed in disturbing the past, the future will be theirs.

At this stage of the struggle it is not easy to forecast the conditions under which public utility investments will actually be made during the next twenty years. The public pressure for a reduction of rates through the exercise of the police power is a continuing force tending to the elimination of the speculative element in public utility investments. At the same time this force, if it is not supplemented by measures calculated to give security to the investment, will tend to drive capital into other fields and to induce stagnation in the development of public utilities. Such a result would be most unfortunate, as in the long run it would involve enormous urban discomforts. There is nothing more vital to the wel-

fare of growing cities than the free and anticipatory expansion of public utility services. When these cease to expand, a city becomes like a foot that has outgrown its shoe. If, however, security follows as a hand-maiden upon rate reduction, unless the latter goes altogether too far, the attractiveness of public utility investments will not be diminished; they will merely appeal to another class of investors, namely, to those who are willing to accept a low return with security.

## FACTS THE PUBLIC MUST RECOGNIZE

The idea that private investments in utilities represent capital temporarily loaned in aid of public credit is the logical conclusion of the non-speculative theory, but many important changes in public policy, as yet hardly initiated, will be necessary before this theory and this conclusion can be fully crystallized into practice. On the one side the public must definitely learn that it cannot eat its cake and have it too. Public service corporations, if they are recognized as a necessary though intermediate agency for the satisfaction of urban needs, must not be harassed by demands that are financially impossible. The public hires them to perform certain services for it and it cannot hope to get these services at less than cost. The first and most fundamental corollary of the philosophy of public regulation of rates and service is the security of the investment and the assurance of a fair and constant return upon it. This security requires the giving up of many long-cherished illusions on the part of the public.

In the first place the fancied protection of maximum or absolute rates fixed by franchise contract for a long term of years must be surrendered. It must be frankly admitted that rate regulation involves the possibility of the increase as well as of the decrease of rates, whenever justice demands it. Especially, it must be frankly recognized that if the standards of service are to be raised year by year, the people who receive the improved service will have to pay for it. The public will also have to reconcile itself to the allowance of adequate depreciation funds out of which the physical plant can be safely maintained at the highest practicable degree of operating efficiency. The public will also have to give up once and for all its lingering fancy for competition in public utilities. It will have to recognize the principle that public regulation of rates and services

is adapted to monopoly and is inconsistent with competition. It will also have to accept the burden of the risk in public utility investments and forego the sweet pleasures of the ward politician and the cart-tail demagogue who would grant franchises for short periods without imposing upon the city any obligation to protect the property at the expiration of the franchise period.

The let-them-take-a-chance policy will have to be definitely discarded. All these changes in public sentiment and public policy will be more or less costly, either in money or in political feelings or in both. In return for this cost, however, the public will receive certain great and definite advantages. It will enlist the steadily responsive coöperation of capital that in its timidity seeks only self-preservation and a diet of herbs. It will secure the recognition of the characteristic obligation of monopoly, namely, to extend its services to satisfy and even to anticipate the reasonable needs of the community. It will secure the coördination of public utility services with the other services of government and establish a sure and steady control over the uses of the public highways. It will ultimately escape from the burden which it has been called upon to bear as a result of the capitalization of the increment in the value of land used for public utility purposes. Most important of all, it will gradually rid itself of the political poison inherent in the "grabbing" of franchises and the regulation of public affairs by utility corporations.

Under all the circumstances, it seems reasonable to anticipate that the need of additional capital to be invested in the expansion of public utility plants will go on in the future much as it has in the past, say, at the rate of half a billion dollars a year in this country; that for some time to come, in spite of this need, capital will hesitate about going into public utilities in those communities where its chance of speculative profit is removed and no compensating security given; that, ultimately, through the full triumph of the theory of public service, there will be a free flow of non-speculative capital into public utilities to the extent that the consuming public is able and willing to pay for the expansion of the service.

# THE RURAL CREDITS ACT AND ITS EFFECT ON THE INVESTMENT MARKET

By Roger W. Babson.

Although nearly everyone realizes that the farm products of the United States are one of the chief sources of our wealth, and many people even believe that our whole prosperity depends on good crops, still there are comparatively few investors who are willing to put their money into the farm loans which are being issued today. Moreover, those who do invest in them are able to exact anywhere from 5 per cent to 12 per cent and in some cases even much higher interest rates on such funds. Why is this so? The answer is that the farmer has never put up his securities in the right kind of a package, and he has failed to advertise. Consequently, his loans have had only a narrow market and have not commanded the terms to which the farmers' credit has really entitled him. These are the things the new Rural Credits Act proposes to do.

There was a time about thirty-five years ago when farm loans were the rage. It was during the period when the Middle West was booming and speculators had pushed land prices way beyond their real value. At that time the loan and trust companies handling the accounting of farm purchases had loaned up to two-thirds of those inflated prices. Then came the wild scramble for the new lands farther west. Eastern holdings fell to half their mortgage face value, and throughout the late '80's and early '90's they were practically unsalable. Then in the far west the same wild cat financing soon took place. Many investors who had lost in the local eastern trusts and loans tried to recoup themselves in these new western ventures, and were caught again in the collapse caused by the panic of 1893.

## Present Distribution of Farm Loans

Although the memories of those days have never been entirely wiped out, the status of our rural credits has since then been almost reversed, and farm mortgages, as a whole, during the late years have really come to rank among the safest investments. This fact is

shown by the great interest taken in these loans by banks, insurance companies, and similar institutions which have practically a monopoly of this business at the present time. In this connection some figures compiled by Mr. C. W. Thompson of the United States Department of Agriculture are exceedingly interesting. Mr. Thompson estimates the total farm mortgage debt of the United States as about $3,600,000,000. Of this amount the banks appear to furnish from their own funds approximately $740,000,000 or more than one-fifth. This proportion of course varies in the different sections of the country, and in certain states is very much larger than one-fifth. For instance, in California the farm mortgages held by banks represent 45 per cent of the estimated total farm mortgage debt; in Louisiana 45 per cent; in Indiana and Michigan nearly 40 per cent and in Mississippi and South Carolina more than 36 per cent.

Life insurance companies are of almost equal importance in this field. Of the total, they supply approximately $700,000,000 which is nearly one-fifth of the total amount of farm mortgage capital of the United States. The insurance companies have confined their operations largely to the four states of Iowa, Missouri, Kansas and Nebraska, practically one-half of the total amount of insurance money being invested in these four states. Iowa alone holds over $150,000,000 of such investments by insurance companies. In Nebraska the insurance companies have over 40 per cent of the business; in South Dakota 33 per cent; in Kansas 35 per cent; in Indiana 37 per cent; in Oklahoma 40 per cent and in Georgia over 50 per cent. These life insurance companies either have their own farm mortgage loans department through which they receive and pass on all applications for loans, or they purchase farm mortgages outright in the commercial market.

The latter practice is generally limited to the smaller insurance companies, their volume of business in this field not being sufficient to warrant the maintenance of separate machinery for the selection of farm mortgage securities. Nearly all the larger companies, however, have well organized departments through which they carry on a regular farm mortgage loan business. Ordinarily these companies receive applications from their local agencies or banks. The application blanks and legal papers used by these companies have been carefully standardized and adapted to

the conditions of the various states of which loans are made. Really the system has been worked out in excellent shape and for the most part the insurance companies which have such an organization are at the present time giving the farmers very good service. While some of the companies show a tendency to charge high rates, insurance companies as a rule represent a conservative class of investors in the farm mortgage business.

Figures are not at hand to show the amount of capital invested in farm mortgage loans by mortgage companies, but these companies are all prominent in nearly all parts of the country, and there are a number of foreign mortgage companies who are heavily interested in the West, South, Central, Rocky Mountain and Pacific States. It is also impossible to tell just how much capital is supplied by private investors. In certain states, however, such as New York, Pennsylvania, Michigan and Wisconsin, the amounts of such capital are relatively large. I have quoted these statistics simply to give some idea of the situation as it now stands. Generally speaking the farmers have been receiving good service in their financing; *but many of them have had to pay very dearly for it.*

## HIGH RATES OF INTEREST PAID BY FARMERS

In short, the matter of interest rates charged on farm loans is really the cause of the Rural Credits Bill. Of course conditions vary with the different sections of the country. In New England and the Middle Atlantic states and a few of the Middle Western states a considerable part of the farm loans carry as low as 5 or 5½ per cent interest; but in certain of the western and southern states, 10 and 12 per cent, and even much higher rates have been exacted by lenders. As we have stated above, the fault has not been entirely with the mortgage companies or other institutions who bought farm loans, but rather with the farmers, who failed to mobilize their credit so that the rank and file of investors could interest themselves in their securities.

Certainly from an investment standpoint, these farm loans have been an excellent proposition for any investor or institution that had the proper facilities for selecting and purchasing them. On the other hand, the average investor could not take the risk of lending his money to a farmer he had never seen, nor did he feel any safer in taking as security a mortgage on property he knew

absolutely nothing about. Moreover, as farm loans are not listed on any of the exchanges, it has been difficult for him to purchase such loans if he cared to, unless he happened to live in a farming community. These are the difficulties which the Rural Credits Act aims to correct.

### THE REVOLUTIONARY NATURE OF THE NEW LAW

Really this is one of the most revolutionary pieces of legislation ever enacted in this country. In a nut shell, the new plan is this: First the country will be divided into twelve districts, each of which will have a farm land bank. These banks will be operated much the same as any other bank with a president, and all the usual banking machinery. Farmers who wish to obtain loans will form local associations through which they may make application to the farm loan bank of their district. This bank will take the mortgages on their farms as security for the desired loans. It will then turn over these mortgages as collateral to the Federal Farm Loan Board at Washington, which has supervision over the entire system, and from it will receive authority to issue bonds to cover the loans which it has made. These bonds are the crux of the whole plan. They will be in denominations of $25, $50, $100 and $1,000 and will probably be listed on the New York Stock Exchange. Although the rate of interest will not exceed 5 per cent per annum, and will probably be considerably less, still they will be exempt from all taxation and their security should be above question. These features should guarantee for them a good demand.

### THE MAIN FEATURES OF THE PLAN

The above is simply the bare skeleton of the plan, but in order to appreciate the status of these new securities and their probable effect on other investments, we must first know more about the organization and detail of the system. There are really five parts of this big money loaning machine. These parts may be briefly described as follows:

(1) *National Farm Loan Associations.* These are local associations which may be formed by any ten or more farmers in a good locality who are already, or about to become, land owners and who wish to borrow an aggregate of $20,000. They are really little combinations of borrowers who band themselves together for the

purpose of securing money. Each association will have a board of not less than five directors, and the directors will elect a president, vice-president, secretary–treasurer and a loan committee of three members.

The organization of the farm loan associations is such that the farmers will have a direct interest in their successful operation. Each association has capital stock valued at $5 a share, of which each member must buy an amount equal to 5 per cent of his loan. Moreover, in case the association should default, this stock carries a double liability, the owner being obliged to furnish an amount equal to the value of his stock, as in the case of the national banks stocks. It is evident, therefore, that each member of the association will see to it that no bad loans are made. Their loan committee will appraise each property and each loan must be approved by their board of directors, all of whom are members and own stock in the association. Each member will therefore be well protected against bad loans. The secretary-treasurer, who handles all funds, will be under surety bond. Moreover, no loans will be made to exceed 50 per cent of the value of the land, or 20 per cent of the value of the buildings, which is an exceptionally wide margin. It is evident that these farm loan associations are really the cornerstone of the whole system.

(2) *The Federal Land Banks.* As soon as practicable, the country will be divided into twelve districts known as federal land bank districts. Each district will be given a number. They will be arranged with proper regard to the farm loan needs of the country, but no district will be a fractional part of any state. In some convenient city of each of these twelve districts there will be located a Federal Land Bank. Moreover, this bank may have branches in other parts of this district. Each federal land bank will have a capitalization of at least $750,000, in shares of $5 each, which may be subscribed for and held by individual firms or corporations, or by the government of the United States. No stocks will have any voting rights, except shares owned by the United States and by the national farm loan associations (above described), but all stock except that held by the United States will share in any dividend distribution.

While this stock will be offered to the public, it is not expected to receive a very enthusiastic reception. Dividends, at least for

a time, will probably be small and the stock carries no voting power when held by the individual investor. The intention is to have this stock eventually held by the farm loan associations. When a farm loan association makes application to a land bank for a loan, it must accompany the same with a subscription for stock of the land bank equal to 5 per cent of the value of the loan desired. This of course really means that the individual farmers will own the stock, but all of the dealings of the federal land bank are with the association as a body. No transactions whatever take place between the land bank and the farmers individually. In case of default, it is the association and not the individual which is held responsible by the land bank. This is an important feature, greatly increasing the security of the system.

In their functions these land banks will occupy a position similar to that of the Federal Reserve banks. All applications for loans will be made by the farm loan associations to their respective land banks. The bank will then verify the report of the loan committee of the association (mentioned above) by having an appraisal made by its own appraisers. If the security appears to be satisfactory, it then forwards its check for the amount of the loan to the association. In order to obtain cash to make these loans, the federal land banks have the power to issue bonds against the first mortgages which they have taken as surety for the loans to the associations. These bond issues, however, must first be approved by the Farm Loan Board.

(3) *Federal Farm Loan Board.* At the head of the federal farm loan banks will be a Federal Farm Loan Board. This board will have its headquarters at Washington. The Secretary of the treasury and four others appointed by the President of the United States make up this board. The men who have been chosen for these positions are Charles E. Lobdell, Republican, of Great Bend, Kansas; George W. Norris, Democrat, Philadelphia; Capt. W. S. A. Smith, Republican, of Sioux City, Iowa; and Herbert Quick, Democrat of Berkeley Springs, West Virginia. Mr. Lobdell has been a farmer, a lawyer and a banker. Mr. Norris is a director of the Philadelphia Reserve bank. Captain Smith is a farmer. He has been connected with the Department of Agriculture and is an expert in that line. Mr. Quick, formerly editor of *Farm and Fireside,* has devoted himself to the study of rural credits and other

problems connected with farming. The Farm Loan Board in this system corresponds to the Federal Reserve Board in the new banking system. Besides passing on all applications for farm loan bonds, the board has charge of all mortgages, notes, etc., held as surety for outstanding bond issues, and has general supervision over the whole system.

(4) *Joint Stock Land Banks.* The above three wheels make up the machinery. In addition, however, two substitute wheels have been provided, for use in emergencies. The first of these is the joint stock land bank. In order to be fair to certain land companies and banks which have already been established to loan money to farmers, a provision to take care of such banks has been made in the law. By this provision, farmers who do not want to form an association and become a part of the big machine, may go to a private institution (to be known as a joint stock land bank) and there borrow their money. These joint stock land banks will be somewhat the same as national banks, each independent and privately operated.

To borrow money from a joint stock land bank, it will not be necessary to be a member of a farm loan association. Moreover, such a joint stock land bank can issue bonds more freely than a federal land bank and is not so restricted in many ways. The bonds which these joint stock banks will issue will be taxable, but they will not be so fully secured as the farm loan bonds above mentioned. Therefore, while they will pay a higher rate of interest, they will probably not be so attractive as the farm loan bonds above mentioned. Of course, if something unforeseen happens so that the big federal machine does not work smoothly, there will be an opportunity for these private joint stock land banks, but otherwise their growth will be slow.

(5) *Federal Land Bank Agents.* If after the system has been in effect one year it is found that a national farm loan association has not been formed where it is needed, the Farm Loan Board may then appoint some bank, trust company or mortgage company in that locality to act in the capacity of such an association. To my mind this is a very important feature of the law and should insure against its failure. The only weakness here is that the local bank must guarantee the loan, although it receives only one half of one per cent per annum on the unpaid balance for so doing.

### ATTRACTIVENESS OF THE FARM LOAN BONDS

Analyzing the new system as we have above, it is evident that everything has been done to make the farm loan bonds absolutely safe and as attractive as a low yielding bond can be. There are four features to these bonds which are especially important: (1) The bonds are secured to at least their face value by first mortgages on farm property; (2) They are secured to the extent of 10 per cent by the land bank stocks owned by the associations in the district in which a default may occur (these stocks are held by the land banks all the time); (3) They are the obligation of all of the other land banks, which are liable for all farm loan bonds issued, whether by them or by some other land bank; (4) Provision is made for the repayment of farm loans on an amortization plan, so that the security behind the farm loan bonds is gradually strengthened. Viewed from all sides, it is evident that these bonds are better secured than even government bonds. Another point which will add greatly to the attractiveness of these bonds is that they are exempt from all taxation. This means a great deal nowadays, as is evident from the tremendous amount of trading in municipal bonds and other non-taxables.

Regarding the effect which these new bonds will have on the bond market, there is a great diversity of opinion. Some claim that there will not be enough farm loan bonds offered to have any definite influence. They believe that most farmers will continue to borrow from the same sources that they have in the past, rather than bother with the new system. Personally I should not be surprised if this were the case at first, but as soon as the farmers realize the great advantages which the new credit system offers them, there should no longer be any lack of applications for loans. I feel especially sure of this in view of the monetary situation in this country. Just now, credit,—that is, for short terms,—is the most plentiful thing we have, but as soon as the war stops we are likely to see an entirely different turn in money rates. Then there will be plenty of use for all of the credit machinery we can bring into play. Moreover, this year's poor crops should also operate toward the same end, especially in sections which have been most severely affected.

Statistics show that at the present time the farmers in at least 22 states are paying an average of 8 per cent or more for money, while in fully 6 states they are paying 10 per cent and 12 per cent,

or even more. Out of the total of about $3,600,000,000 of farm loans there are about $900,000,000 drawing 8 per cent or more in interest. Under the rural credits system, the highest rate of interest which can be charged on these loans is 6 per cent, and it is very unlikely that more than 5 per cent interest will be asked. This means that on perhaps a fourth of farm loans, which are now outstanding the farmers can make a saving of from 40 per cent to 100 per cent, or even more in interest charges by joining the new system. Frankly, I do not believe that it will take these farmers long to wake up to the new plan.

### THEIR EFFECT ON THE BOND MARKET

What does this mean to the bond market? First, I believe it means that all of our low-yielding, high-grade bonds will find a sharp competition in the new farm loan bonds. Institutions, trustees and individual investors who have been accustomed to buy low-yielding railroad bonds because of their safety, will find in the new farm loan bonds an equal degree of safety coupled with exemption from all federal, state, municipal and local taxes. The result must be a considerable scaling down in prices of the low yielding railroad issues. In fact, these new farm loan bonds will be rivals to United States government, state government and municipal bonds, and their appearance may have a depressing influence on these issues also. At least, the trend should gradually be in that direction.

Another result of the new system will be, *ultimately*, to make good farm mortgages practically extinct, and the holders of the mortgages will gradually turn to other investments yielding from 5 per cent to 6 per cent. For the most part I do not believe that the interests who are now holding farm mortgages will buy the new farm loan bonds, as they are obliged to seek a higher interest return. This demand should tend to stimulate the prices of good high-yielding securities. Of course I do not believe that these changes will come about immediately. The new system will probably not be put into operation until next spring, and as above suggested, it will doubtless be some time after that before it becomes very popular. On the other hand, I do believe that the principle of the new plan is sound, and that eventually it will displace our present system, or systems, of handling farm credits. Wise are the investors who prepare for the changes which will take place.

# THE RATE OF INTEREST AFTER THE WAR

By Irving Fisher,
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There are so many unknown or imperfectly known elements in the world-war and so many others which lie in the uncertain future that it would be impossible to make any very definite predictions concerning the rate of interest after the war. Much depends on whether the United States will be drawn into the conflict, on whether the European nations will repudiate their debts, on what will be the character of taxation after the war, on whether banking systems will collapse, whether the issues of paper money will be increased, whether emigration from Europe will be large or small, whether the tides of international trade will abstract gold from this country, whether new inventions, stimulated by the war, will materially affect industry, and on other possibilities beyond the ken of man.

All that we can do at present is to make arbitrary assumptions as to such unknowns,—to assume, for instance, that the United States will still remain out of the conflict, that the paper money situation will not grow much worse, if at all, that emigration from Europe will not constitute any considerable exodus, that national bankruptcies will, for the most part, be avoided, that taxation, after the war, though heavy, will not be comparable to the sacrifice of current income during the war, that no great influences on international trade, beyond those which are already obvious, will come forward, and that inventions will grow out of the war which will be of great use in industry and will require the investment of much capital.

## The Determinants of the Rate of Interest

I have stated in *The Rate of Interest* what I believe to be the true principles on which the rate of interest depends. I shall not try here to summarize these principles further than to say that the rate of interest expresses the degree of human *impatience* for *future* dollars (or dollars' worth of enjoyable goods) as contrasted with *present* dollars (or dollars' worth of enjoyable goods). It relates to the terms on which present dollars will exchange for future

dollars. In such an exchange present dollars are at a premium, and the premium is the rate of interest. If all dollars, present and future, are supposed to have the same purchasing power over goods, the premium on present dollars, registering our impatience or preference for the present over the future, will depend on the relative *abundance* (as seen in the present) of present and future dollars, or of the present and future enjoyable goods which dollars will buy. Thus, the premium which we put on present dollars will be enhanced if present dollars are scarce. It is the man and the nation which is pinched today that will wish to borrow and will be willing to pay high rates for the accommodation. If, under ordinary circumstances, a man is willing to promise to pay $105 next year for the sake of securing $100 at once, he may be willing to pay a much higher price than said $105 if he is now in serious straits from which he expects to be relieved in the future. In other words, if the rate of interest is ordinarily 5 per cent, it will be more than 5 per cent if the present income of the world is temporarily reduced. The rate of interest depends largely on the *distribution in time* of the income stream.

The basic fact, therefore, on which any prognostications concerning the rate of interest must be determined is the expected stream of income to those concerned in determining the rate of interest. When, in general, the income stream of a nation is rising, that is, when it is increasing in time, the rate of interest will be high. Thus, in new countries, with great expectations, people feel safe in promising large amounts out of future expectations in return for relatively small amounts in hand at once.

## EFFECTS OF THE WAR ON INCOMES

Now the most salient economic fact of the war is that the nations engaged in it are suffering an immense reduction in the income of their people. It is estimated that the people of Great Britain, France and Germany had an aggregate income before the war of approximately $80,000,000 a day and that the current cost of the war to these three countries is now about $60,000,000 a day or three quarters as much. This cost includes only the official expenditures of the three governments. It does not include the destruction of private property nor the loss of productivity. Most of the $60,000,000 a day (four-fifths in England) comes, in the first instance,

from loans, that is, from the accumulated wealth of the world, mostly of the belligerent countries. Exactly what the reduction in real current incomes has been (*i.e.*, from taxes, destruction of goods and lessened consumption) no one knows, but it is undoubtedly a very large percentage. It is estimated that the annual interest charge on war loans will, after the war, equal or surpass the total national budgets before the war.

But, as soon as the war is over, the thoughts of all will be directed to reconstruction and all Europe will be in the position of a new country, poor in immediate comforts but (relatively) rich in future expectations.

Such a condition will make for a high rate of interest. The spirit of Europe will be one of eagerness and impatience, just as is the spirit during the up-building of a new country; and this eagerness and impatience will be registered in a high rate of interest as they were while our forefathers were making America.

It is conceivable that curious things may happen to complicate this result. If the war continues much longer the government bondholders will be the virtual owners of Europe for years to come. The income tax for the rich may reach 50 per cent. The taxes on the poor may be equally oppressive. Rather than pay such tribute, for a lifetime, to the bondholder—who may not then be so popular as he is today!—the taxpayers may, by the wholesale, emigrate to the United States. Wealthy people, of more foresight than patriotism, after taking good care to sell out any holdings in government bonds, may change their residence to where taxes will not seem to be confiscation. The fate of European nations would then be similar to that so common to "assessment" insurance companies, which after gaily loading themselves up with obligations, lose their paying membership and go into bankruptcy.

But even such an outcome, or others which might be imagined, would not substantially alter the main result, namely that the owners, whoever they are, of Europe after the war will, during the re-building period, be eager borrowers and will lift up the rate of interest.

I am quite aware that many business men believe, on the contrary, that the rate of interest will be low. Those who reach this conclusion reason along what I believe to be fallacious lines, in some cases even falling into that ancient pitfall of thought, the

"money fallacy" of interest, according to which the rate of interest is supposed to be inversely related to the amount of money in circulation. This and other fallacies I have discussed in *The Rate of Interest* and shall not discuss them here.

It is worth noting that what has been said concerning the future rate of interest applies from the moment peace is in sight. It does not fully apply before that time. During the war itself the rate of interest has been, as I predicted that it would be, in the *New York Times*, August 30, 1914, extremely variable, owing to the fitful fluctuations of numerous changing conditions. In the world as a whole, it has been somewhat higher than before the war and tending during the war to grow higher in Europe and lower in the United States.

## LONG-TERM VS. SHORT-TERM LOANS

There should be noted, however, an important distinction between short-term and long-term loans and this distinction is especially important during war. When, in war time, a business man makes a loan to run for a time so short that repayment is expected to occur before the comparative opulence of peace, the contrast between the needy present, when the loan is contracted and the *still needy* future when it is repaid is not as great as in the case of a long-term loan, the repayment of which is expected to be made after peace and prosperity have come. One is willing to repay more liberally after the crisis is over than during it. It has thus come about, as we should expect, according to the principles laid down, that the rate of interest on long-term loans has, in general, risen more as well as fluctuated less than that on short-term loans.

As soon as peace is in sight or within a few weeks thereafter, long- and short-term loans will be more normally related, that is, the rate of interest on the two classes will be more nearly equal. For both, the rate will, I believe, rise immediately or soon after assurance of peace, the rate on short-term loans rising most, so as to catch up with the rate on long-term loans.

It should be noted that we are here speaking of pure interest and not of interest with the alloy of insurance against risk. The test of the correctness of our results must be made, therefore, by reference to industrial securities rather than to loans of governments engaged in war. Undoubtedly the announcement of peace will

raise the price of *government* bonds, at least of the victorious countries, because of increased confidence in the solvency of these countries. But such a phenomenon means a lower risk and not a lower rate of interest properly so called.

## The Influence of Patriotism

Additional reasons for these conclusions concerning a high rate of interest after the war are to be found in other directions.

During the war patriotic fervor keeps the *pure* rate of interest below what it would be if the war loans were made on a strictly business basis. In fact, it is probably true that most of the subscriptions to government loans are made, not so much for investment purposes, as "to help the cause." As soon as the war is over this element tending to keep the rate of interest down will vanish, or at any rate, greatly diminish. Governments will have to renew their loans at real market rates.

Thus far, I have spoken chiefly of the psychologic causes operating on the rate of interest, but these psychologic causes are conditioned on objective physical conditions. I have spoken of the war as cutting down the income stream of society and leaving at the end of the war, therefore, a prospect of a rapid ascent out of the depression.

The rate and manner of ascent, however, are not rigidly prescribed. There will be many different opportunities open to the survivors of the war from which to choose and the nature of this range of choice will be an important factor in fixing the rate of interest. Those who have the task of reconstructing Europe will be confronted with alternative methods and degrees of possible reconstruction. The manner in which the existence of many different optional methods of production and therefore of investment, enters into the determination of the rate of interest, is very subtle, but very important.

A land owner in the devastated regions of France or Belgium, may find that to re-build, re-stock, re-plant and fertilize his farms in a certain specific manner and degree will offer returns in the future out of all proportion to the required sacrifices in the present. That is, contrasting what he can expect from prompt and full repairs with what he can expect without them, he notes a vast gain in the future for a small cost in the present. A present outlay on his

land of $10,000 may offer a return in future years equivalent to, say $2,000 a year, making a rate of return on sacrifice of 20 per cent. If, therefore, by mortgaging his land, he can borrow the desired $10,000 even at a high rate, indeed at any rate less than 20 per cent, he will be glad to do so. He will be an eager borrower because he has a great opportunity. Such great opportunities for large returns on small investments from the rapid re-building of Europe, the reconstruction of her cities, ships, warehouses, factories, railways, roads, bridges, the re-stocking of dealers, will presumably be in evidence almost everywhere. The existence of such opportunities,—that is, of large possibilities of future returns on present sacrifices,—will make men impatient, impel them to borrow and tend to raise the rate of interest.

### EFFECT OF INVENTIONS ON INVESTMENT

The rare opportunities for investment which will present themselves soon after the end of the war will probably be further enhanced by a number of technical inventions to which war always stimulates the mind of man. Inventions originally made for military purposes often have industrial uses, while, in addition, blockades and other interruptions of ordinary industry and commerce, lead directly to industrial inventions. An example of the first type may be seen in commercial submarines and aeroplanes, as by-products of military submarines and aeroplanes. Examples of the other type are also before us. American watch and clock manufacturers formerly imported their crystals but, the supply having been cut off by the war, and "necessity being the mother of invention," they have devised new and improved methods of making crystals themselves. How many and how important may be the commercial inventions growing out of the war no one yet knows. I shall be surprised if in the aggregate the influence of new inventions is not considerable. Inventions, by offering big future returns for comparatively small present sacrifices in developing the inventions, tend to raise the rate of interest.

### CREDIT WILL RAPIDLY EXPAND

Finally, one important result of the ending of the war will almost certainly be a rapid expansion of credit which will tend to create a period of rising prices and a high rate of interest which

usually goes with such "boom" periods. In order to conserve gold, European nations are trying to get the public more used to the check system. Such a change, which has long been overdue on the continent, will probably, after the war, go on by leaps and bounds. The French government, for instance, is urging the people of France to practice deposit banking in order to "mobilize the national cash," *i.e.*, to draw it out of French stockings into French banks. The bank of France is distributing a pamphlet of explanation and instruction in the American system. If this prognostication proves to be correct, the credit expansion will lead to a continued rise in prices, except so far as this result may possibly be checked by the resumption of specie payments, by a policy of contraction and by the cancellation of paper money. But, up to the present time, paper money inflation has not progressed far. According to Professor Whitaker, whose figures relate to the close of 1915, the paper pound sterling had depreciated relatively to gold, as measured by foreign exchange rates against the American dollar, only about 2½ per cent, the French franc only about 12 per cent, and the German mark about 21 per cent. Moreover, it is not likely that these depreciations will be rapidly diminished in view of historical precedents after the Napoleonic wars, after the civil war, etc.

Even if a policy of rapid resumption of specie payments should be adopted, I have little doubt, assuming that the inflation at the close of the war is not much more than at present, that, for many years after the war is over, there will be a general rise in prices, a general period of expansion and with it a high rate of interest, such as almost invariably accompanies boom periods. It would not surprise me if, within a year after the close of the war, the general rate of interest in England, France and Germany should average 7 per cent or above.

### Interest Rates in the United States

What has been said applies primarily to the warring European countries and not to the United States. So far as the United States is concerned, the effect will, I believe, be in the same general direction but not so pronounced. The credit relations connecting the two sides of the Atlantic will be reversed, we becoming lenders to Europe instead of borrowers from Europe.

The level of interest rates in Europe has hitherto been below

ours and therefore tended to draw ours down. Hereafter it will be above ours and will tend to draw ours up. We have already bought hundreds of millions of European securities or bought back American securities held by European owners. Mr. Loree, President of the Delaware and Hudson Railroad, estimates that a half billion of dollars' worth of United States railroad securities alone were returned to this country from abroad inside of six months.

It should be added that the present low level of the rate of interest in the United States is abnormal. Owing to the very sudden increase in our gold reserves, which could be utilized by the banks only by extending their credits, these banks have extended their credit by offering low rates until their deposits become the requisite multiple of the reserve. The low rate is simply a temporary incident connected with the adjustment in the loan machinery. When the present readjustment is complete I anticipate that the rate of interest in the United States will be considerably higher than at present, quite irrespective of the ending of the war.

The foregoing are some of the reasons why I cannot share the opinion of those who believe the rate of interest after the war will be low. It has been argued that Europe will be so crippled after the war as not to have much borrowing power. Now it may well be that the borrowing power of Europe will be smaller if the war is prolonged than if it were to end today. But the important point is that Europe, whether she be a big borrower or a little one, will be a borrower instead of a lender. Moreover, an outlet for American funds seeking investment will be found in those outlying countries formerly accustomed to borrowing in Europe. The Argentine and other South American countries and the Orient will tend to borrow hereafter in the United States. This result will also tend to raise the rate of interest in the United States.

In closing, I would repeat that I realize the existence of unforeseen elements and the fact that those which can be foreseen are unknown in their relative importance. This fact makes such a forecast as I have attempted only a very tentative affair. While I feel considerable confidence that the rate of interest in Europe, for many years after the ending of the present war, will tend to rise and that this country will feel some effects of the rising tendency, no quantitative prediction as to the magnitude of this result can be other than a guess.

# THE NATIONALIZATION OF CAPITAL

By Dr. M. J. Bonn,
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## I The Growth of International Investments

In the half century preceding the war there was a decided trend towards international finance. Capital flowed from some of the old countries notably England, Germany, France, Switzerland, Belgium or Holland into the newer countries. It was not a mere export of capital as it is commonly called, by which capital—whatever meaning we may give to that somewhat multicolored term—migrated from one country to the other. The characteristic feature of the movement was that though the capital itself emigrated its owners remained at home, drawing interest on their foreign investments and pocketing profits from their enterprises abroad—wherever such profits were made. In other words credits were given by the citizens of one nation to those of another nation on an ever increasing scale.

Some of these credits took the form of short-term advances repayable within a few months. They were used mostly for the movement of goods from one country to another. As such movements recurred periodically the advances had to be renewed over and over again. They were a kind of international revolving credit.

The older countries, England and Germany for example, were in the habit of paying cash for their imports of raw material. Their citizens no doubt used instruments of credit in their individual transactions. They paid the producers of copper and cotton by drafts on their bank. By selling these drafts immediately the producer got cash. Though the purchaser himself took up the draft only after it fell due, the banks had advanced the money for discounting it abroad, either through branch banks or through foreign correspondents. Broadly speaking imports were paid in cash, while through the same system of bank accommodation abroad exports were sold on credit, of three to twelve months' duration. A considerable share of the capital of England, and to some degree of Germany, was thus engaged in short-term credits to foreign nations.

A much larger share was permanently invested abroad, bearing interest or bringing dividends. The cost of transportation, the cheapness of raw material, the building up of protective tariffs, or the requirements of some patent law, forced manufacturers to start branches abroad.

The German chemical industry, for example, had branches established in Russia, because import duties on their products were very high. They started some in England on account of the neighborhood of the greatest consumers, the British textile industry. A German candy making concern of international fame started branches in some countries, because the tariff made imports from Germany impossible. They went to England because the cheapness of sugar and of raw materials enabled them to hold their own on the British market, and to avoid hostile tariffs in foreign countries.

Direct industrial investment was but one form of the international advance of capital. Far greater were the sums of money loaned by one nation to another by means of issuing stocks, shares and bonds, through the different stock exchanges. Huge sums of foreign government loans were subscribed in Europe. They had to compete with bonds and shares of corporations which raised their capital in markets where the rate of interest was low. North and South America railroad corporations; South African gold mines; Near and Far Eastern enterprises vied with each other in competition for the foreign market. Germany participated largely in these international credit operations. Her foreign investments before the war have been variously calculated at seven to eight billion dollars. It has been estimated that her investments in hostile countries alone were nearly five hundred million dollars. During the year preceding the war, the total amount of issues offered to subscribers upon the German exchanges reached six hundred million dollars of which about sixty-three million dollars were for foreign ventures.[1]

## II Intricacies of International Finance

International financial (credit) relations were not restricted to loan transactions between groups of advanced countries and of new

[1] In many cases the amount of stock issued is offered at the same time on several stock exchanges. It cannot be estimated how many of the subscribers are Germans. Moreover, it is not known to what amount German capitalists subscribe to loans in foreign stock exchanges.

countries. Countries were not coupled together in pairs of creditors and debtors: Germany, for example, had no monopoly of lending money to Turkey. She shared in these transactions with France, England and other countries. Finance was not merely what might be called bi-national; of late it had really become international. The creditor countries, England, Germany, France and others who loaned money to weaker states were tangled up among themselves as creditors and debtors. Their financial relations had become so close and intimate, they depended on each other to such a degree, that many a competent observer denied the possibility of a big war on account of that financial interrelation. A kind of international clearing house had grown up, and a kind of international stock exchange had been developed. London had become the center of international business.

England's geographical position made her the half-way house of central and eastern Europe for trade over sea. It made her safe apparently from foreign invasion. Her history and her institutions guaranteed the safety of private property from injudicious government action. She was the heart of the British Empire which produced a large percentage of the world's raw materials. She had imported huge quantities of them while the rest of the world was yet satisfied to live on its own produce. She had evolved an excellent trading organization. Her banking system was peculiarly well adapted for the granting of short loans essential to trade. She kept a much larger share of her capital for that purpose than any other nation. Quite naturally she became the market, the clearing house and the banker of her own colonial empire. Hers was the greatest merchant marine and she did much of the carrying for other nations. She controlled the insurance systems of many countries. She had invested huge sums of money abroad, the interest on which had to be remitted. She owned the greater part of the world's gold-producing areas, from which a stream of gold converged in London. She received freightage, bank commissions and insurance premiums from all the world. Her colonial empire offered far greater facilities in the near future than any other place in the world: she attracted men from all countries to her colonies. And to London she called the financial genius of many lands, especially from Germany, by wise hospitality and the offer of splendid chances.

*England as the World Center*

A triple result followed. England became the staple place for many imports. With a population of but forty-six millions, her imports were 3.7 billion dollars; while those of Germany, with a population of sixty-seven million were 2.7 billion dollars. In the four years preceding the war, England's reëxports of foreign goods were well over five hundred million dollars. England enjoyed a better market organization than her competitors. Dealing in futures, for example, was possible on a big scale. Though the consumption of copper in Germany was 260,000 tons, and the consumption in England only 140,000 tons, the turnover at the London Metal Exchange was 524,000 tons, whilst the turnover in Germany was 360,000 tons.

The result of this was that international payments were made via London. International accounts were cleared in London. The exporters in South America and North America, as well as in the British colonies, were paid in bills accepted directly or indirectly by London banks. There was an enormous demand for those bills, and the pound sterling was the currency of the world. It has often been said that a draft on London was as good as gold. Up to the outbreak of the war this was true, and all the world used it for payments. For limited areas only, the mark, the franc and the dollar were international currency.

*Germany's Relations with London*

Germany settled a good part of her foreign trade payments via London. She imported large quantities of raw materials from British colonies. She exported goods to them. It was but natural to settle these bills via London. Non-British payments were settled in a similar way. The German banks erected branches in London or kept an account with London banks. They deposited with them a large amount of Germany's floating capital, for English banks would never accept drafts for German accounts without being sufficiently secured and compensated. What held good of Germany held good of other countries, too, to a limited degree. They all kept balances in London. It has been estimated by the Frankfurter Zeitung that German credits in London were well over $500,000,000 a year.

Economic internationalism went much further. The vast domain of the British Empire produced many raw materials which

Germany wanted. German trading firms had to take permanent interests in those countries. The refining of Australian metal ores was largely done by German concerns. German companies furnished the power plants for the South African gold fields. British textile industries would never have maintained their primacy all over the world if it had not been for the close coöperation of the German dyestuff industries, which established branches in England.

There was quite an important counter-movement of this sort. Some of the British concerns controlled German textile mills. British capital was very strong in the German cigarette industry. Bills on Berlin were bought in England, partly for the settlements of eastern Europe payments, and partly for capital investments whenever the rate of interest was high.

These investments were overshadowed by the vast participation of German capital in flotations on the London Exchange. The London stock exchange had lately become the international stock exchange. The number of securities listed there was greater than anywhere else. It was well organized and honestly managed, though it gave greater chances to the gambler than its German competitor.

In Germany no issue was admitted for quotation without a detailed prospectus. The information contained in the prospectus was carefully checked by an official committee before quotations were permitted. Moreover, no shares of less than $250 could be issued. Dealing in futures was very restricted. Risky issues like gold mines or rubber shares could not be floated. People who wanted to risk their money in comparatively small sums had to do it in England. Foreign shares subscribed abroad could not be traded on the German stock exchange without paying a heavy tax. Moreover, the claims of home industries had been strong for many years. The rate of interest in Germany was higher than in England and in France. It was cheaper to borrow money in London and in Paris. The best foreign securities as well as the most risky ones were quoted there, and many a conservative German capitalist invested the bulk of his money in good foreign securities, while he gambled with the rest in gold shares. There was a time when the brokers handling South African mining shares kept a small army of traveling salesmen going all over Germany. On the other hand, first-class investments like American railroad shares were largely subscribed in London by

German capitalists. Moreover, most foreign bonds and shares quoted in Germany were listed in London and Paris as well. Very often it was more profitable to buy in London than anywhere else. In that way a large share of Germany's permanent investments, not only in British securities but also in other foreign securities, were made in London. This state of affairs was openly acknowledged in England. There was a regular influx of German brokers and financiers into the London stock exchange. They brought with them their nimbleness of wit and their power of adaptation, and they brought, too, a crowd of German customers. Patriotic Englishmen have lately denounced them as "our German exploiters," forgetting evidently that they made their money out of their German compatriots at home and spent it in England.

### III NATIONALIZATION OF FINANCE NOW UNAVOIDABLE

Long before the war, a movement against the internationalization of capital had sprung up in Europe. This started in France but it found an echo in Germany and in England. Protectionists realized that the export of capital on a credit basis worked against their policy. If new countries were quickly developed by capital drawn from home, great quantities of competitive goods might be cheaply raised, cheaply transported and cheaply marketed. The development of a huge wheat-growing area in Mesopotamia might offset the high duties on wheat in Germany, and lower the price for the consumer. At the same time the outflow of capital to more productive fields abroad would raise the rate of interest at home. The margin of profits for protected interests would be decreased. These arguments were easily answered in the days before the war: as long as nations relied on foreign supplies, economic expansion by means of advances to new countries is beneficial. Foreign loans very often gave the control over foreign markets. The possession of international securities is a great asset in time of trouble as they can be liquidated abroad. Internationalization of payments reduces the cost of payments and equalizes the rate of interest all over the world. Moreover, it was thought that financial internationalism is the forerunner or a powerful ally of a permanent world peace.

This answer will not be deemed sufficient today. All the world has realized the danger of international dependence in time of war.

International communications can be cut by any power which controls the sea. Since the American government has accepted the principle that the maintenance of international trade between neutrals in time of war is not vital, provided the damage done to individuals is properly paid for afterwards, the sheet anchor of the world's international communication is gone. With the oncoming of "nationalization of business," the nationalization of finance seems unavoidable.

## IV The War's Effect on German Foreign Investments

It is very unlikely that European countries, or even groups of countries, will become completely self supporting. However big the groups and however excellent their organization may be—they will depend upon foreign supplies. As far as Germany is concerned she will try to get them by land, which is the real meaning of the proposed plans of the Central European Customs Federation. But she will not withdraw from foreign commerce oversea. She will not rely upon them as she did before. She will use her capital for foreign investments as she has done in the past wherever it is to her interest to develop the resources of foreign countries. But foreign credits will be more exclusively extended to countries in whose coöperation full confidence can be placed.

The war no doubt will throw a very heavy burden on Germany. No one can foretell what her future productive power will be. But two features are clearly outstanding:

1. Germany has undoubtedly disposed of a considerable part of her foreign securities, but she has retained a large share of them. The property which is withheld from her citizens by the Allies was estimated at $500,000,000 before Italy and Roumania declared war on her. A large part of her neutral securities has not been sold as there were not available markets for them. All of these sums will be released when peace is made. No doubt Germany will have to re-stock her stores at that date. She may have to contract short-term foreign loans in order to prevent the efflux of gold, her untouched assets are more than sufficient for such transactions.

2. Germany will remain a creditor nation. She has contracted no foreign obligations during the war. However heavy the burden may be, her people will not be compelled to pay tribute to foreigners.

## V DECLINE OF LONDON'S FINANCIAL PRESTIGE

While the relations between debtor countries and creditor countries will continue, and while Germany will partake in them, international finance, in the sense of that close coöperation of capital which existed before the war, will not revive for a long time. The London money market will not be used by borrowing nations in the future as it has been used in the past. It will not any longer be the place where the capitalist nations of the world meet to do their work in joint coöperation.

As far as settling international trade via London is concerned, some vital changes are sure to occur. The old belief that a draft on London is as good as gold has been shattered. England was forced to declare a moratorium. She was forced to do so because she was the international center of the world. As soon as the international trade machinery came to a standstill, payments to England were difficult to make, and England was not rich enough to meet all the demands on her. In other words, the banker of the world had to postpone payments because many of his clients had to do so, and because his own resources were not strong enough to carry him through. "Lombard Street," a British author wrote, "will have to modify its boast about the only free and open money market in the world."

It is quite possible that this moratorium was a wise and unavoidable measure. It is absolutely clear that it has demonstrated to the world, and especially to the neutrals, the danger of keeping their bank account with a country mixed up in all business and in all struggles of the world. However excellent service the international mechanism, especially in London, may have done, the dangers inherent in such an international financial machinery have been clearly demonstrated. In the near future people will be shy of such forms of internationalism, which no doubt do cheapen business in time of peace but lead to bankruptcy when war breaks out.

If a country could be found with all the natural and political advantages England enjoyed, she might take the place of England, if her neutrality were assured under all circumstances. But even then no country would be rich enough in her own liquid resources to pay her debts to her creditors when her own debtors failed. At the outbreak of the war the United States paid both England and

France though both failed to pay her. This country could do so because its international commitments were comparatively light.

The United States is not likely to take the place of England as a center of international finance. Commodities en route to Europe do not pass her shores and never will do so. Their economic policy, their commercial policy, their corporation and stock exchange legislation are far less stable than those of England. In that respect the advantages of a free trade country are not at the disposal of a protectionist country. But America is sure to do the financing of her own trade. As she will no longer be indebted to England, there will be no need for her to send the same amount of remittances to London, and the same will hold good of other debtor countries whose bonds England is selling to the United States. Their place in London will be taken to a certain degree by the British Dominion and Allies.

There will be no need to finance American imports via London. The demand for London drafts from America will be much smaller. And it is not very likely that the payments on foreign account for Russian and Italian product, for example, will go via London. Even if the economic schemes of the Allies are realized, Germany certainly will not finance her imports from Russia via London. As far as the British colonies are concerned, she will have to do so if she chooses to buy their goods. If the colonies refuse to do business with Germany, they will facilitate Germany's financial emancipation from London, as she can get the raw products needed from other sources. She will pay for them either directly or via New York. Countries or groups of countries will settle the payments of their exports and imports directly. They will try to oust superfluous financial intermediaries.

## VI Permanent Effects of British Policy

Far more important will be the effect of the war on permanent investments in foreign countries. These permanent investments may be roughly divided into two groups:

1. Establishing of commercial and industrial firms in foreign countries.

2. Participation in foreign enterprises by investments abroad in government bonds and corporation stock and bonds.

As far as those investments are concerned, the war has brought about a very great change. To begin with, a recrudescence of the

protectionist spirit is visible all over the world. There will be a cry for the creation of national industries at very great sacrifices, as the war has shown the danger of such industries under foreign domination. Countries will favor the influx of capital into such industries, as the Germans have done with nitrates and the English with dyestuffs. They will prevent the efflux of capital as long as home requirements are not fulfilled.

The investor himself will be far less eager for investments abroad than he was before. The closing of all stock exchanges all over the world has made it difficult for him to realize his foreign assets, even if they were first-class. The moratorium enacted in nearly all countries with the exception of Germany, shows the risks of buying foreign bills. Moreover, the foundation of the international financial fabric has been smashed deliberately.

### *All Payments to England's Enemies Forbidden*

In that respect, England was the leader. As early as August 5, trading with the enemy was forbidden in England. The first proclamations which were neither clear nor stringent did not stop the payment of debts. Later on all payments to business residents in the enemies' country were forbidden. Dividends, interest, profit on securities or on participations in some business belonging to Germans and to people residing in Germany, were withheld from them during the war. They were to be paid into the hands of a custodian. This custodian was empowered to collect all revenues belonging to enemy subjects. Moreover, all enemy property, companies, corporations and private firms were handed over to a controller who became their receiver. Transfers of enemy property to neutrals were stopped.

In other words the capital of enemy subjects in the British Empire was sequestered. The revenue accruing from it was withheld from them. Their business secrets were wormed out, their books were inspected, their property was to be managed in the public interest and not in the interest of the party concerned. As the object of this legislation was to damage enemy subjects, the administration of their property was very often made as harsh as possible. Competitors of British firms were deliberately ruined, stocks and shares were sold without regard to the owners' interest, collateral securities were disposed of at a loss. Not only British

securities but neutral securities deposited in London were dealt with in that way. I know of an old lady living in Germany, whose income is derived from American securities listed in London. She does not get a cent from them. I know a small pensioner in Munich who is deprived of her pension from England. Even German citizens living in the United States cannot get their dividends from England.

*Retaliation by Germany and Austria*

British legislation was inaugurated on August 5, 1914. It was quickly copied by the Allies. As a matter of course, Germany and Austria retaliated. At the beginning the advantage was with England for her obligations to Germany were far larger than her own investments in that country. She wanted to cripple the enemy and did not think of future developments. She was not quite successful in many ways. She could not stop liquidation of German securities in neutral markets, but she seemed to be a gainer in the beginning. The unpaid trading debts of the central powers in England were but one million pounds. Affairs changed quickly with the entrance of Turkey into the war, a country which owes large sums to England and especially to France. Following the Allies' example she confiscated their investments and cancelled their concessions. The entrance of Portugal and Italy and Roumania has restored the balance in favor of the Allies. But the economic benefit derived from such measures must be much smaller than was originally considered. An absolutely reliable balance between the assets and the liabilities of the different nations cannot yet be struck.

*The Permanent Effect on International Finance*

What is far more important than figures is the deathly blow dealt to the system of international finance. Before the war, continental investors liked to spread their risks. They felt convinced that their investments were safe. It might be doubtful whether a government would go on paying interest on their debt to the enemy when war broke out. Japan has done so punctiliously to her German debtors. But private property and private obligations seemed to be quite safe. As private property cannot be confiscated even in occupied territory by a hostile army, there seemed to be no reason why the possibility of confiscation should be taken into account, where no direct military necessity was involved. England's con-

ception of international law which is based mainly on maritime law, aiming at the destruction of private property, did no doubt furnish arguments for the legality of such precedents. The acceptance of the Declaration of London seemed to show clearly that England was giving up her old ideas. It seemed to make investors quite safe. They have been grievously disappointed. Whatever conclusion lawyers may come to about the legality of such sequestration will be of great legal importance when the question of compensation is discussed. As far as the essential financial relations between nations are concerned, the legal learning exhibited during the war is of little weight.

What does matter is the experience people have gone through. They have learned that their foreign investments, whatever form they may take, are not safe in hostile though civilized countries. They have learned that neutral securities are not safe when listed in such countries or when intercepted at sea even if protected by neutral mails. They have learned that corporations or firms owned by them but domiciled in neutral countries can be boycotted without protection by friendly neutral goverments. For the most valiant protest is no protection. They will draw their conclusions from their experiences and nationalize their finance. If international law experts can show them that all of these acts were lawful, so much the worse. For that would guarantee them that such acts may be repeated without fear of punishment or hope of compensation. No country has learned sadder lessons from the war in that respect than Germany. She and her Allies will draw their own conclusions. A reconstruction of economic policy all over the world will take place, by which nations and states will be distributed in big economic groups. They will overstep their group boundaries wherever national interests are at stake for the exploitation of new countries oversea. But the old unorganized flow of capital towards the largest profits abroad, is not likely to continue. There will be a drawing apart of nations and groups in economic life and with it a considerable setback to international finance.

# LONDON AND NEW YORK AS FINANCIAL CENTERS

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Since the beginning of the present European war there has been a great deal of discussion in the financial papers and elsewhere as to the effect of the war on London's position as the financial center of the world and the probability of New York succeeding in assuming and keeping the position. It is, of course, natural that the serious interruption in shipping, commerce and exchange throughout the world would minimize for the time being London's supremacy, especially when the stupendous task of financing not only Great Britain's munition requirements but those of her Allies devolves upon her.

There is no question that at the end of the war, New York's position as an exchange and financial center will be vastly enhanced but not necessarily at the expense of London. Sovereigns and dollars are the only two important mediums of exchange that have been at all reliable since the war commenced and this will no doubt put both of these exchanges immeasurably ahead of the exchange of any other country at the end of the war.

## The Reasons for London's Supremacy

London has been for centuries the commercial clearing house of the world. This is due not only to its central situation, its immense foreign trade and its large mercantile navy, but also because, through its highly perfected banking system, it provides facilities of such magnitude and of such entire efficiency for the final settlement of exchange operations, that drawers or negotiators of bills in every quarter of the globe gave preference to sterling over any other form of exchange. It has been estimated that nearly 90 per cent of all letters of credit issued throughout the world were, prior to the war, drawn in English money. Lloyd George, in commenting on the unique and commanding position of Great Britain in international trade and the consequent serious responsibility placed upon her at the outbreak of the war, said in November, 1914:

> We had not merely our own business to run; we were an essential part of the machinery that ran the whole international trade of the world. We provided the capital to raise the produce; we carried half the produce, not merely of our own country, but of the whole world. More, we provided also the capital that moved that produce from one part of the world to another, not merely for ourselves, but for other countries.
>
> I ask anyone to pick up just one little bit of paper, one bill of exchange, to find out what we are doing. Take the cotton trade of the world. The cotton is moved first of all from the plantations, say, to the Mississippi, then it is moved down to New Orleans; then it is moved from there either to Germany or Great Britain or elsewhere. Every movement there is represented by a paper signed either here in London or Manchester or Liverpool; one signature practically is responsible for the whole of those transactions. Not merely that, but when the United States of America bought silk or tea in China the payment was made through London. By means of these documents accepted in London, New York paid for the tea that was bought from China. We were transacting far more than the whole of our own business; we were transacting half the business of the world as well by means of these paper transactions. What is also important to establish is this: that the paper which was issued from London has become part of the currency of commerce throughout the world.

In considering the possibility of New York being a successful rival for supremacy as the exchange and financial center of the world, we can do no better than review some of the principal reasons why London has hitherto held that position and, it will be realized that New York must duplicate these conditions in great part if not in entirety before London can be dethroned. These reasons and conditions can be tabulated briefly under three headings, physical, psychological and economic, those coming under the first heading are of course unalterable, under the second heading can be remedied in time through education and training and under the third heading are matters of legislation and custom.

### I. Physical Conditions Favourable to London

London is situated on the threshold of Europe in the heart of the world's commercial activities, directly opposite the estuary of the Scheldt and nearly opposite that of the Rhine and is within a short distance of every important exchange center in the world with the exception of New York. This alone may be considered as an insuperable obstacle to New York's ambition.

London has the advantage of ice and fog free water lanes to every large port in the world with the exception of New York; the

climate is equable and liquids and perishable goods run little or no danger of freezing in winter.

The restricted insular area of Great Britain, a little larger than the state of Minnesota, is also an important factor, as it not only affords an immense seaboard compared with its size, but concentrates the population. A frequent and rapid transit service makes Great Britain practically one large city with London as the business center. Every bank in the country has a branch or correspondent in London, carries its reserves there and clears direct with every part of the country through its London agent. The economy of resources effected by this natural concentration of funds is seldom realized and is worthy of study. The insular position of London renders it comparatively free from the danger of invasion and seizure by a hostile power and this immunity has been a factor in making London a world depository.

The geographical situation of Great Britain, coupled with her willingness to invest money in international utilities, has placed her in a unique position as regards mail and cable facilities. Through her immense mercantile navy London has direct communication by fast steamers with every important port in the world and consequently acts as a foreign mail clearing house for all other countries. If French, German or Dutch steamers afford a faster service to any point they can be utilized with little or no loss of time.

As Great Britain owns and operates two-thirds of the submarine cable mileage of the world, it is natural that London should be a great cable center with practically direct communication the world over. This service is now supplemented by a far flung system of wireless stations. Furthermore, under normal conditions, every main railroad on the continent of Europe gives its best service and equipment to its London mail train. The Trans-Siberian Railway already gives access by rail to the Pacific and it is only a question of time to the establishment of through connections with India, China and South Africa.

In dealing in foreign exchange and stocks London is the center of the world as regards time. She knows the conditions in eastern markets before they close and is open long enough to operate in New York before her own markets close. Her position is therefore pivotal as regards time and distance. Time is the essence of an exchange transaction, a day's delay may turn a profit into a loss

and, granting that New York has the means and enterprise to create an efficient steamship and cable service in due course, how can she eliminate the more serious handicap of distance by water from all other financial centers?

## II. PSYCHOLOGICAL CONDITIONS

Perhaps a better heading than this would have been national characteristics. Great Britain is a land of slowly acquired fortunes and the banker and merchant there are content with small profits and slow returns. They have long realized the fact that trade follows the loan and have therefore been willing to invest money in foreign countries with no prospect of recovering immediate returns or large profits, and the financing of these loans abroad has been an important factor in making the London money market so supreme. It is doubtful if the American is adapted temperamentally for operations of this kind or for the small profits of the exchange operations connected therewith. The United States has still a vast area in proportion to its population, its natural resources are not yet fully developed and it is a country of large and rapidly acquired fortunes. It will, therefore, be many years before the investors and entrepreneurs are forced to direct their attention to foreign fields. Great Britain, before the war, invested over a billion dollars annually in foreign enterprises and at the beginning of the war had between twenty and thirty billions so invested. The United States at the same time was a debtor nation for over six billion dollars, and allowing that some two billions of this amount has been paid off or absorbed in the past two years of the war she will still have to invest nearly twenty-five billion before she is on an equal footing with Great Britain in this connection.

The average family of Great Britain is large compared with that of the United States and there is little room and few opportunities at home for the younger sons. This class man the army, the navy and the mercantile marine and go abroad as clerks, etc., to foreign and colonial banks and commercial houses, the more venturesome, as soon as they acquire experience, carry British trade and prestige to new and undeveloped countries,—British subjects are found everywhere, no matter how remote the place.

The young American, on the other hand, has so many opportunities at home that there is little inducement to venture abroad

except for pleasure. He is probably the only son of the family and takes up his father's business or is assisted in setting up in business for himself. If he does go abroad, he is not content with a subordinate position, but wants to be his own master and strike out for himself. Preferably he goes back home to do this. We might instance the experience of the International Banking Corporation, a state bank, chartered in Connecticut with foreign branches chiefly in the Orient. This bank, though an American institution, is manned principally by Englishmen. It will be interesting to watch the personnel of the staff of foreign branches of the national banks established under the Federal Reserve Act.

### *Sectional Jealousies in the United States*

To be a world center of finance it is essential that a city must in the first place be the unquestioned financial center of its own country. London is indisputably recognized as the financial center not only of Great Britain but of the British Empire. No local jealousy is evinced by Birmingham, Liverpool, Glasgow or other large cities as to London's supremacy in this regard. New York is the principal financial center of the United States, but it is not the only financial center. Chicago, St. Louis, San Francisco and other important centers are strong competitors with New York for domestic business and to a certain extent for foreign business. Aside from sectional jealousy, the vast area of the United States makes this competition inevitable. Will these cities abandon selfish motives and aid New York in her ambition? Will not the expansion of the country's foreign trade accentuate rather than diminish this competition? Chicago and Minneapolis will share in the development of the great Canadian West, San Francisco will become more and more important with the extention of business with the Orient and New Orleans will benefit by the opening of the Panama Canal and the expansion of trade with South America. The United States is not a country but a collection of countries or commonwealths of which New York State is only one. The tendency is to minimize New York's financial supremacy rather than to assist it. A study of the discussions on this feature preceding the passing of the present Federal Reserve Act will bear out this statement.

It is not a question of the ability and enterprise of the American,

but one of his overcoming the handicaps of temperament, environment and tradition and we might add prejudice and suspicion as the world has not yet forgotten the frequent and serious crises in American financial history.

Mr. Hartley Withers in his excellent book, *The Meaning of Money*, puts the case succinctly as follows:

> It is a cherished ambition among Americans to see New York some day established as the monetary center of the universe, and with their vast natural resources and population there is no doubt that the United States can achieve any material tasks that they choose, if they can learn the necessary lessons and develop the necessary character. At present the characteristics of the typical American business man seem to fit him to do most things better than banking. His haste to grow rich, his eager enthusiasm and buoyant optimism followed by plunges into apprehension and depression, his quickness and versatility, his keen sensibilities, his craving for speculative excitement, and his genius in exaggeration—all these qualities make him an excellent producer, a first-rate distributor, a miraculous advertiser, an unapproachable gambler, and a somewhat questionable banker. There are hundreds of good bankers in the United States, who take a scientific interest in the problems of their business such as is comparatively rare among their English brethren. But they are developed in spite of their environment, and of the atmosphere of eager enterprise which makes it difficult to observe the humdrum laws and limitations of banking.

London's supremacy is the cumulative result of numerous forces, political as well as economic, spread over a long series of years during which time the world has learned to think in terms of British money and the bills of exchange on London have been raised almost to the dignity of an international currency, while the safety of the Bank of England and the value attached to the word "sterling" have become proverbial. Sovereigns and to a great extent Bank of England notes pass current the world over without recourse to money changers. The dollar and the dollar bill must be made equally well-known and acceptable.

### *The Influence of Custom and Tradition*

It must not be overlooked that, when an international business is so long established and well centralized as the money market of London, the world will continue to use it as a matter of convenience rrespective of the possibly superior facilities of New York. The financial roads to London are well defined by much travel, and business tradition will favor the old stand; it is human nature the world

over to follow the cow track across a pasture no matter how oblique its direction.

One of the main foundations upon which London's position rests is the world's estimation of its credit. This credit is tried and sound, backed by great resources, and has been reared upon the trust and confidence in the honorable tradition of British business ethics and it is unlikely that the world will have cause to revise its opinion after the war is over. In a recent article in the *London Bankers' Magazine* a writer (Mr. Benjamin White) says in part:

> As to what will be the credit of the British Empire among the nations of the world after the war, there is no reason to imagine that it will be diminished. The burden of financing our great allied nations has fallen upon her shoulders. The bonds of trade between the Allies will be forged closer, and it will be done in Great Britain's workshops. If the British nation were effete and decadent, there might be some reason to fear that hands which tried in vain to snatch the trident from its grasp might rob it of its financial crown. But the fact that four to five million of the Birtish race have flown to arms voluntarily in order to defend their heritage gives to such an insinuation the lie direct. The British race is still virile and the world will not be discouraged from leaving its balances in London when it reflects that London's sons have shed their blood willingly in Flanders to maintain the honor and credit of British plighted word. British banking will not attract less confidence abroad when it is found that the shock of the greatest war the world has ever seen has not disturbed its equilibrium. A liner in foreign ports flying the British flag will be none the less welcome because the British navy will have crushed a revival of piracy upon the main, and by so doing will have secured the freedom of the seas to all peaceful traders.

## III. Economic Factors

The principal economic factors which tend to enhance London's position as a financial center may be considered under the following heads:

- Free Gold Market
- Liquid Discount Market
- Stability of Money Rates
- Immense Mercantile Navy
- Great Foreign Export and Import Trade
- Tariff
- Excellent Banking System at Home and Abroad
- The Numerous Branches of Foreign and Colonial Banks Established in London
- Freedom from Panics and Financial Disturbance
- Free Navigation Laws
- Marine Insurance, etc., and reliable Ship Registration

*London a Free Gold Market*

Of the four great exchange centers of the world, London, New York, Paris and Berlin, London is the only one that can always be depended upon to meet every legitimate trade demand for gold, which means that there is no delay or premium entailed in realizing gold on a bill expressed in English money. It is payable in pounds sterling which represent a definite and immutable weight of fine gold. Great Britain adopted the gold standard unequivocally in 1816, over one hundred years ago, and has not departed from it since, even to the extent of charging a fractional premium on gold or by restricting its export by legal or sentimental embargoes. Even war conditions did not deprive the Englishman of the privilege of converting Bank of England notes into gold and, if he were willing to take the risk of shipping it, he could pay a debt in Europe or America without let or hindrance. Hon. Walter Runciman, President of the British Board of Trade in speaking recently of Britain's trade and financial power said:

> It never has been necessary for us to prohibit the export of gold. We are prepared to meet our liabilities on a free gold basis. Since August 1914 Great Britain has exported £13,850,624 gold bullion and coin in the *ordinary course of business*, in addition to large sums exported by the Bank of England for Government account, and no individual is prevented from meeting his liabilities abroad in this way if he prefers to settle by bullion transactions.

Even in normal times other nations have not assumed this position. The Bank of France always reserves the right to pay in either gold or silver so that in times of stress it could charge a premium on gold. The Imperial Bank of Germany though theoretically obliged to pay gold makes it very uncomfortable for any bank or customer who has the temerity to demand gold for export purposes. Both France and Germany, since the war, have abandoned any attempt to maintain a gold basis.

New York, though generally willing to part with gold for export purposes, was—at least up to the establishment of the Federal Reserve system—handicapped by the lack of machinery for the efficient and economical mobilization and control of the gold reserves of the country.

England is not only committed to an undeviating policy to maintain a free gold market but enjoys peculiar advantages in this

connection. Great Britain is not only the largest creditor nation of the world but also controls and supplies, within the British Empire, nearly two-thirds of the raw gold output of the world and has the control automatically, independent of any exchange movements, of over $350,000,000 newly mined gold each year. Owing to this natural gold income Great Britain has been able to maintain her position as a free gold market during the whole period of the war and its bank notes and treasury notes have been and still are redeemable in gold at the Bank of England on presentation.

It is true that since the war London's activities as an international gold market have been curtailed owing to the disturbances in trade routes and difficulty and risks of ocean transportation, but, so important is the certainty of the English monetary standard and financial policy to the merchants and brokers of the world, that it is unlikely that the war will cause more than a temporary recourse to other methods of settling international obligations.

### *Also a Liquid Discount Market*

The natural complement of a free gold market is a liquid money market capable of absorbing bills of exchange to an almost unlimited amount. This unique feature of the London market makes a first-class bill of exchange on London as acceptable as gold. The strength and broadness of the London market, apart from the natural resources of the country, lie in the ebb and flow of foreign capital through the machinery of the branches of foreign and colonial banks established there.

Although London does not particularly encourage the establishment of foreign banks, it, on the other hand, does nothing to restrict the movement and allows freedom in banking privileges to all comers of good standing. This broadminded policy though it perhaps affects to a certain extent the individual interests of some of the British banks is recognized as of great importance to London and the country in general, and therefore indirectly to the banks themselves. These branches of foreign banks, with their network of correspondents throughout the world, in addition to their direct influence on the exchange situation, give invaluable assistance to the Bank of England in preserving the equilibrium of the money market.

The policy of New York in connection with foreign banks is

just the reverse of that of London and is apparently based on a local and narrow point of view. New York bankers have always discouraged the establishment of foreign banks in their midst and have evoked state legislation and other means to this end. A few foreign banks are represented by agents, not by branches, they cannot take deposits or discount commercial paper and their activities are practically restricted to making call loans and dealing in foreign exchange.

The London discount rates are controlled by a central institution, the Bank of England, and changes in the rate are not only infrequent but seldom rise above 6 per cent. By this control of the money market through the bank rate as it is called, the Bank of England has been able to attract gold to London by raising the rate whenever the exigencies of commerce and the exchange situation require it.

Reference has already been made to the ability and willingness of Great Britain to invest its large surplus income in foreign and colonial securities and thus provide foreign countries with the means of paying for British merchandise and machinery. The movement of such investments forms a large part of the so-called invisible exports and imports and is necessarily an important factor in creating exchange and adjusting international balances.

### *The Mercantile Navy and Tariff*

The absence of a tariff in Great Britain except on a few specific articles is of great importance, as not only do foreign goods find a ready market, but it permits British merchants and others to import goods into Great Britain free of duty and export them at their convenience. London and the other important seaports of Great Britain correspond to the freight yards at railway centers, cargoes consisting of goods of every description pour into these ports from all parts of the world and are there sorted into mixed cargoes to be despatched to various countries. In other words London also acts as a clearing house for cargoes.

The United States is so irrevocably committed to a high tariff that it is unlikely that any appreciable modification will be possible for some time to come, though this obstacle in New York's path might be removed in great measure by the establishment of free ports.

Large amounts of British capital have been invested in the establishment of British banks in her colonies and in foreign countries with head offices in London, and these render invaluable assistance in the operation and preservation of British foreign trade and commerce.

Great Britain possesses a mercantile navy second to none in the world. This not only means an immense toll on the world's commerce in the way of freight, etc., but also enables Great Britain to govern to a great extent the destination of cargoes. Incidentally, with her large ship owning, Great Britain is naturally interested in marine insurance, and owing to the excellent standing of her insurance companies does an immense business in foreign marine insurance. Lloyds, an association of English underwriters of marine insurance, collects and distributes by cable reliable maritime intelligence through its agencies established in every part of the globe; it also issues Lloyds Register, giving the rating, etc., of every British and foreign ship.

British navigation and shipping laws are liberal. A foreign ship is in the same position as a British ship with regard to British trade, and foreign ships engaged in the coasting trade are not subjected to higher port rates than British ships (141 Custom Law Consolidation Act 1876). British law affords equitable protection to both British and foreign seamen, but avoids emasculating the service by undue paternalism.

The navigation laws of the United States have always been a serious handicap to her shipping business and the recently passed La Follette's Seamen's Law will still further embarrass the unfortunate American ship owner.

*England's Enormous Foreign Trade*

Under normal conditions Great Britain has an immense export and import trade with every part of the world. This great commerce is not only of material benefit to the country generally but the constant flow of inward and outward remittances forms an invaluable nucleus for London's foreign exchange operations, and bills of exchange can be bought and sold in London drawn on any place in the world, no matter how remote. For the year ending December 31, 1913, the imports of Great Britain were £768,734,739 against exports of £634,820,326 representing shipments from and to

every country of the world. At the end of 1915, excluding certain goods belonging to the British and allied governments, the figures for which are not available, the exports were £483,444,459 against imports of £853,756,279 a shrinkage of about 23 per cent. It is evident that Great Britain is still able to maintain the bulk of her export trade notwithstanding war conditions and the shortage of bottoms.

Great Britain has a fully developed banking system, eminently adapted to the requirements of her international trade and finance, which has been ably and successfully conducted through a long series of years by highly trained bankers, in whose judgment and conservatism the British public have every confidence. Consequently the country is practically immune from panics and other financial disturbances. The banking laws are simple and impose no unwise restrictions as to legal reserves, etc., leaving such questions to the individual judgment of the banks themselves. Experience has shown that good banking is obtained not so much by good laws as by good bankers.

We have now reviewed briefly the principal reasons to which London owes her financial supremacy and though the events of the past two years have brought New York into a position of financial eminence and power, it remains to be seen how much of this power has been thrust upon her temporarily and how much she has acquired permanently at the expense of London.

*New York's Present Dominance Temporary*

Since the war commenced the United States has gradually changed from a debtor to a creditor nation, principally owing to the fact that vast exports of munitions, etc., have been made to belligerent countries, thus creating an abnormal trade balance in her favor. With this shifting of international balances, large amounts of gold have been received from debtor nations, a considerable volume of American securities held abroad have been absorbed by the New York market and large loans made to the belligerent nations, as well as to Canada and other countries of the American continents.

Owing to the position of the United States as a wealthy neutral nation, far removed from the scene of conflict, a wide demand has also developed for dollar exchange and dollar credits, not only in the United States but in foreign countries. In other words, the ab-

normal conditions induced by the war called upon New York to take the position of international bankers heretofore played almost exclusively by London. This rôle was assumed by New York, not so much of her own volition as by force of circumstances. Will these war time opportunities, when peace is declared, be sufficient to retain for New York the position which London with all her advantages took centuries to acquire? Before New York can do this to any great extent the United States must learn to think internationally and not provincially. It must increase its foreign trade tremendously and revise its navigation and alien labour laws and its tariff, all with a due regard to the comity of nations; sound permanent banking and currency systems, removed from legislative tinkering must also be established, and finally foreign banks should be encouraged to establish branches in New York and other centers without unnecessary restrictions as to the business they may undertake.

One of the leading banks in New York, the Mechanics & Metals National Bank, has expressed itself as follows in a recent monthly letter:

> Today, to be sure, there is more trade passing in and out of the harbor of New York than in and out of any other port of the world. Before the war, the trade here was less than that of either London, Hamburg or Liverpool. But more than 60 per cent of New York's present trade is with four countries of Europe and a great deal of it is due to the purchase of war material for the Allies. This is a state of affairs that cannot be enduring, or even if enduring. that is not designed to shift away from London its historic supremacy among the world's money markets.
>
> In order permanently to fix a new place for ourselves, we must become really a world trade center. Time will show whether we are sufficiently developed for that. To ship to world markets and cultivate them permanently for our manufacturers and merchants, we must become lenders of wealth on a big scale. One of the most familiar axioms of international trade is that commerce will flow where capital flows; one reason for European supremacy in oversea trade has been the tremendous outside investments made by England and France, and more recently by Germany. Our people are not yet educated to loan money abroad in large quantities; in spite of our apparently large loans in the past eighteen months we cannot yet be called in a true sense an international loan market. For example, at the present time, London, with a high interest rate is unable to attract our gold, while we with comparatively low rates are receiving from London more than we want.
>
> Abnormal conditions have for the present destroyed the power of interest rates to direct the flow of gold, but were we an international loan market on a scale

**demanded, we would energetically seek a way to overcome those conditions. Eventually the normal laws of economics will again assert themselves and then will come a fairer test of our position. If then we can meet the situation in a big way, and conduct our affairs in a manner in keeping with a world outlook, it ought to be possible for Wall Street at least to share with Lombard Street the financial premiership of the world, and the responsibilities that go with it.**

In conclusion, I am of the opinion that the financial center of the world will always remain in Europe, if only for geographical and national reasons, but there is need and room for another strong financial center in addition to London and it would always be desirable that such an alternative center should not be located in Europe, as the present European crisis has amply demonstrated.

New York is already the financial center of the new world; she should strengthen and broaden her claim to this position and, as a coadjutor, relieve and assist London in her great responsibility as the world center. In the reconstruction that must follow the close of the war Great Britain and the United States will undoubtedly play a great part and London and New York will find it more and more necessary to coöperate in the performance of their several functions. London is ready now. When the time comes will New York be equally prepared and able to do her share?

New York will doubtless benefit permanently from the advantages and experience gained during the war. Great Britain will profit also from the intimate intercourse with France, Italy and Russia, likely to result from the war which will undoubtedly tend to reëstablish, if not strengthen London in her former position. Great Britain has financed her Allies generously through the war and will not only have these large amounts refunded to her in due course but will receive collateral advantages which should more than offset the business lost to New York.

The conditions, however, that will obtain after the war are too much a matter of conjecture at the present stage of the conflict to warrant an opinion of any value. No one knows how or when the war will end and the whole world, including the United States, may yet be involved.

# OUR GOLD RESERVES AFTER THE WAR

By Frank A. Vanderlip,
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In these modern times the relationship of values the world around is in terms of gold. The standard of value, outside of China and a few unimportant countries, is gold, and local currencies are based upon gold. Even where the domestic currencies are temporarily of paper the relationship of this paper to gold is reckoned upon in all business transactions with the outside world. As soon as the war is over all countries involved in it which have ambitions in foreign trade may be expected to bring the relationship between their paper currencies and gold back to normal at the earliest possible date, by reducing the issues of paper money and by increasing their reserve of the standard metal. Fluctuations in the value of a domestic currency will be an element of uncertainty, and therefore, a handicap, in all business transactions with other countries.

With the domestic currency based upon gold reserves, it is obvious that the entire credit system of each country is based upon those reserves. Bank deposits, bank loans, commercial credits and obligations of every character rest at last upon the gold reserves, and there must be some reasonable relationship between the volume of current credit and the available stock of gold.

## The Great Significance of Gold

Gold is the form of property by which the balances accruing in the trade and financial relations of nations are finally settled, and the effect of a flow of gold from one country to another has become familiar to all students of finance. When the balance of payments is against a country and gold leaves it in settlement, the effect is to reduce the base or foundation upon which the structure of credit in that country rests, and prudence requires that the volume of credit be accordingly reduced or held in check. Small movements of gold, evidently due to seasonal states of trade or other temporary conditions, may be negligible, but an outflow of gold exceeding normal proportions will receive the careful attention of financiers and busi-

ness men. It is symptomatic of unhealthy conditions. It may be that trade has lost its natural balance, that exports are falling off or imports increasing in an abnormal degree; or it may be that the securities of that country are being sent home, either because they have lost favor abroad or because other countries have an emergency need for gold to support their own credit. In any event, if gold is steadily exported from a country there must be, eventually, a curtailment of credit in that country, and higher interest charges as a result. On the other hand, a country which is receiving additions to its gold reserves is in position to enlarge its fabric of credit, and that usually results. With increasing reserves the banks lower interest rates, and encourage borrowers. Enterprise is stimulated, new undertakings are begun, labor and materials are in demand and what is known as a period of expansion is thus inaugurated as a direct result of the inflow of gold.

These conditions react from one country to another, and tend in normal times to maintain an international equilibrium. Thus, in a country which is receiving gold there will be a stimulus to industrial expansion, increased consumption of goods and materials and higher prices, while in the country which is losing gold there is an influence for the curtailment of consumption and for lower prices. The former country will naturally import more and export less, while in the latter country, these tendencies will be reversed, until the gold movement turns over and flows the other way.

## Controlling Gold Movement Through the Discount Rate

All phases of this subject have been long under observation abroad, and particularly in London, which has been for many years the most important international money-market. The Bank of England, as the custodian of the gold reserve of that market, has had more experience with this problem than any other institution, and long ago developed a scientific policy of action now confirmed and adopted by financial authorities generally. It has been demonstrated that under ordinary conditions the gold reserve can be controlled by the discount rate. A rising rate has a tendency to curtail borrowing, and bring about a reduction of loans, with the result that money is paid into the bank on balance. On the other hand, lowering the discount rate encourages borrowing which increases deposits and lowers the reserve percentage even though the reserves are not

actually reduced. There is likely, however, to be a double effect, for when the borrowed credit is drawn upon the bank will probably lose money on balance.

It will be seen that an intelligent control of the discount rate accomplishes the same result that is eventually worked out blindly if no management of the gold movement is attempted. If the central banking institution permits a growing inflation of credit and a loss of reserves, that movement will go on until a crisis is reached, when the bank, having reached the limit of prudence, will be forced to suddenly raise its discount rate or refuse discounts entirely. This action taken abruptly gives a shock to credit and may precipitate a panic. It happened repeatedly in the history of the Bank of England until gradually the policy of foresight and control was adopted. As credits expanded, or reserves diminished, the bank raised the discount rate, thus discouraging the tendency and keeping the situation in hand. In short, instead of having changes in the discount rate follow the inflation of credit and loss of reserves as a result, the latter-day policy makes use of the discount rate, to guide the money-market, check undue inflation and prevent loss of reserves.

## The Bank of England's Use of the Discount Rate

The principles involved in the use of the discount rate were strikingly illustrated in the policy of the Bank of England in 1907, when a banking panic prevailed in the United States. The banking system of the United States at that time was without means of meeting a sudden and general demand for cash, except by importing gold. The interior banks drew heavily upon New York and other financial centers, and the banks at these centers made every effort to procure gold abroad, and particularly from London. Our grain, cotton, meats and other products were exported as rapidly as possible, our securities which had standing in foreign markets were sold at bargain prices, and our credit was used freely for short loans. We were literally buying gold as a manufacturer might buy coal in a time of fuel famine to keep his factory running. We imported about $100,000,000 of gold in two months, and four-fifths of it came from the Bank of England. It was impossible for the bank to stop the flow by any ordinary means. It raised the rate of discount to 7 per cent without affecting the outward movement to the United States, because the inducements offered here far outweighed that unusual

charge. But while the rate did not stop the outward flow, it started an inward flow to the bank which practically offset the former movement. The people who wanted to pick up bargains in the United States continued to borrow, but other people who had no relations with the United States, and who did not care to speculate in a time of alarm, were influenced by the high rate to pay their obligations at the bank as fast as they could do so. Ordinary business was curtailed, men refrained from purchases and investments which they otherwise would have made, and postponed new enterprises to more auspicious times. Money flowed into the bank from the provinces in payment of loans, and, what was more important, from all over Europe. London is a great money market; people go there from all parts of the world, both to lend and borrow. When its bank rate went up to 7 per cent the borrowers upon the continent and in other quarters hustled about at home and raised money to pay off London, while at the same time lenders hurried money to London to take advantage of the high rate. And so it came about that when the stress was over, and after London had shipped $85,000,000 of gold to New York, the Bank of England had a higher percentage of gold reserve than when the movement began.

## Control Through a Premium upon Gold

Such is the recognized importance of the discount rate as a means of controlling the movements of gold, that the Bank of England frequently enters the London money-market as a borrower, competing with the public, in order to raise the outside rate to the level of the bank rate, thus getting the influence of the entire market against a further expansion of credit, with consequent withdrawals of gold.

The discount rate is not the only means adopted to discourage withdrawals of gold. The Bank of France has followed the policy of charging a premium upon gold. Under the old bimetallic system which is still maintained in France, except that the coinage of full-tender pieces has been discontinued, the five franc pieces are still a legal tender, and the bank has the option of paying its obligations in silver. If it desires to discourage the exportation of gold, it exercises this option or imposes a small charge upon gold. This charge has the effect of an ad valorem tariff upon importations, and affects all foreign payments in like manner. The effect is less objectionable in France than it would be if France were not a creditor country.

Foreign capital is seldom employed in France, and therefore, has not been called upon to pay this premium, but the charge has probably operated to the advantage of London and the prejudice of Paris, as a world's money market. Gold will not flow freely to any market from which it cannot be withdrawn with equal freedom.

## Lack of Control in the United States

In years past there has been little appreciation in the United States of the importance of having a banking organization able to cope with this complex problem of the exchanges. We have had a thoroughly decentralized banking system, composed of a great number of independent institutions, organized under different state laws as well as under the national act. There has been no definite responsibility anywhere for the regulation of the interest rate, or for the supply of gold required in the settlement of foreign balances. By reason of being located at the chief port and financial center, the New York banks have had the most intimate relations to the problem, but the competitive conditions existing between New York and other important cities, and between national banks, state banks and trust companies in New York, and the absence of any special powers for dealing with the problems, have all hampered the ability of the New York banks to deal with the situation. As a result there has been but little of that management or control which the Bank of England, and the other central banks of Europe, have continually exercised over the exchanges. We have drifted, and suffered from the extremes of unregulated credit—expansion and the ebb and flow of gold, just as other countries suffered before they learned the secret of control by means of the discount rate. In a period of prosperity there was no responsible authority to utter a warning or to set a limit upon the expansion of credit, and expansion usually went on until the structure became top-heavy, and then an outward movement of gold set in and weakened the foundation until a collapse resulted, followed by a period of depression.

There were always bankers and economists in the United States who understood the weakness of our banking situation, but they were without sufficient influence to change it. In fact it has never been considered the proper thing in the United States to take the advice of bankers about banking legislation. Finally, however, the

panic of 1907 aroused a general public interest in the subject, and the work of the National Monetary Commission in its foreign inquiry made the country fairly well familiar with the fundamental principles which had been demonstrated.

The result was the establishment of the federal reserve system in which all national banks and a few state institutions are included. This gives an organization and cohesion to our banking system which was lacking before. Final reserves have been set aside which are made available to the member banks by means of rediscounts, and the rate for these rediscounts is under the control of the Federal Reserve Board. Although the system of twelve reserve banks is unusual and complex, the principle sought to be put into effect is the same as we see demonstrated in Europe. This system depends for its effectiveness upon the authority and attitude of the Federal Reserve Board. The sense of responsibility to the whole country will be hard to maintain in twelve individual institutions. There is danger that the local or district view will become habitual with the managements, that they will tend to forget their relationship to the system, and that, isolated as it is from actual operations, the Board at Washington may relax its control over them. The burden of dealing with the foreign exchanges, and of supplying gold for the settlement of foreign balances, will fall almost entirely upon the New York bank, but the balances themselves will be for account of the whole country, and the policies for controlling the situation must be participated in by all the banks. It remains to be seen whether this relationship is clearly comprehended, and whether each of the twelve institutions will readily make the sacrifice of revenues to itself, and the curtailment of accommodations to its locality, which at times will be necessary if the system is to do its work effectively. The New York bank has been limited in territory to New York state and small sections of Connecticut and New Jersey for its resources, but it must handle the international relations of the United States.

## Our Present Activity Abnormal

The Federal Reserve Board's control of rediscount rates, if effectively used, will do much to prevent the undue expansion of credit which usually precedes and promotes an outward movement of gold. But the exportation of gold may result from other causes. The great industrial activity which now exists in the United States

is not due to credit expansion, although there is constant danger that undue credit expansion may result from it. Conditions outside of ourselves are responsible for this activity. An abnormal and temporary foreign demand is driving our industries to their capacity, and a great trade balance in our favor is pouring hundreds of millions of gold into our vaults. This influx of gold and imperative demand for our products is radically affecting industrial conditions in this country in a manner unfavorable to our trade position after the war. In normal times a state of unusual industrial activity here will bring hundreds of thousands of laborers from abroad. The productive capacity of the country is thus increased and the effect of the unusual demand for labor is diffused abroad as well as at home. But at this time little or no new labor can be had from abroad, and the efforts to put this additional amount of capital into use are expended upon the existing labor supply. That supply being limited, and the amount of capital seeking to use labor rapidly increasing, the result is that industries are bidding against industries, and employers against employers, and wages are advancing to unheard of figures.

We have had boom periods in the United States before, but never one when conditions were so abnormal as now. We are perfectly aware that they are abnormal, and cannot be maintained when the war is over, and yet we are daily creating new relationships upon this basis which cannot be readily changed. We know that when all the men engaged in war and upon war work go back to producing peace products the prices of all such goods will fall, and the entire fabric of costs will have to be made over. Experience teaches that costs can only be reorganized on a lower basis under pressure, the pressure of competitors who are taking the market. We have to expect, therefore, after the war that we will be undersold not only abroad but at home and that a balance of trade upon merchandise account will be created against us. If it is not so it will be because we show a facility in readjustment which no people have ever shown before, and the only hope of this lies in sounding the warning continuously.

### Foreign Demands for Our Gold

Furthermore, at the end of the war there will be pressing need for capital in all the countries that have gone through the strain of war, and for gold for use as the basis of credit. Every practicable

effort will be made to attract gold. If present efforts to induce the holders of American securities to part with them do not clear the strong boxes, further efforts may then be made. Moreover, our government is giving assistance, by making our income taxes apply to the foreign holders of our securities, something we have never done in the past. At present rates of taxation everywhere few people will care to be subject to taxes under two governments.

There has never been a heavy movement of gold to this country that was not followed by a return movement, and it cannot be expected that this extraordinary occasion will prove an exception. The United States is acquiring far more than its share of the world's gold, measured by any standard of distribution that has been known in the past.

## How to Control Gold Exports

When the return movement appears there will be means of mitigating its force, in the foreign loans that have been placed in this country. These obligations of foreign governments, banks, corporations and individuals, falling due in one and two years as they mature, will count in our favor as so much gold. Evidently they can be allowed to run off with less disturbance than would follow the withdrawal of gold from our bank reserves after it has been made the basis of domestic credit. These foreign loans will be our first line of defence, and they will be an important bulwark. After them will come the gold holdings of the Federal Reserve Bank of New York, and as these shrink, the supreme test of the federal reserve system will come. Will it meet the crisis as twelve banks, or as one organization? The Federal Reserve Board has authority to call upon the other reserve banks to rediscount paper for the New York banks, which would effect a transfer of gold, and there is every reason to believe that the Board as now constituted, will direct this to be done.

Even so, however, the available gold resources of the system are not what they should be. The total stock of gold in the country is approximately $2,550,000,000, but the holdings of the twelve reserve banks are only $536,000,000. The United States Treasury holds $1,466,000,000 of gold against which certificates for an equal amount are outstanding. Excepting what is in the federal reserve banks, and the banks of the central cities, this gold is practically out of reach. It is a part of our wealth but it does not serve the purpose

of a gold reserve. The efficiency of gold is largely lost when it is used as ordinary till money, or carried about in the pockets of the people.

### INFLUENCE OF THE FEDERAL RESERVE SYSTEM

The Federal Reserve Board made an effort at the last session of Congress to obtain greater freedom for the reserve banks in acquiring gold, and its recommendations were logical and apparently conclusive, but timidity and a mistaken conservatism defeated the proposals. The system will not be as strong as it should be, to support the business interests of the United States, until means are adopted to place a larger proportion of the gold stock of the country where it is available for use in time of need.

There has been some ill-advised criticism of the reserve banks for not having made a better showing in the matter of earnings. So far as this criticism is directed at the costly policy of creating twelve banks when one-half that number would have answered the essential purposes of this system, there is a basis for them, but it must be borne in mind that when these banks extend themselves freely in normal times they lose the power to control the situation when a crisis comes, and this is the occasion for which they were created.

Outside of the foreign loans now being made in the United States we have no body of foreign indebtedness here upon which our domestic interest rates can be made effective in a crisis. We cannot, therefore, expect the discount rates of our federal reserve banks to have the same influence upon an outward gold movement as the Bank of England is able to exert in the London market. Our rates can be effective only upon our own borrowings, and in keeping down the volume of credits which may be based upon this stock of gold upon which we have but a precarious hold. As yet the rates of the reserve banks have been scarcely a factor in the market, owing to the abundance of cheap money, but their function is not to make credit cheap, but to keep credit in reserve and have on hand a stock of gold which can be released for export with a minimum disturbance to credit conditions in this country.

# AMERICA'S ABILITY TO MAKE FOREIGN INVESTMENTS

By Hon. George E. Roberts,
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Looking forward to the period following the war, there is every reason to believe that a great demand for capital will exist the world over. Normal development is now in check, in the countries at war and also in the neutral countries, but the forces that make for progress, although under restraint, are gathering weight and as soon as the war is over will make themselves felt. Population is increasing even in the warring countries. The stress of war conditions is favorable to the development of initiative and enterprise. When the war is over, there will be much lost time to be made up, and much planning to increase the productiveness of industry in all countries.

What part will the United States be able to play in this situation? We know that in the past it has been a borrowing country, a field of investment for the old countries of Europe. No other country has grown so rapidly in population, and this growth, while stimulated by the demands of capital striving to take advantage of the opportunities present here, has in turn created an enormous demand for capital to build the cities and the railways, and provide the accommodations and facilities required by a population of 100,000,000 people. The result has been that nowhere else have the rewards of capital been so great as here, and there has been little inducement for American investors to go away from home.

This outstanding fact of our history naturally prompts the question whether after the war America will have any capital to spare for investment in other countries, under the normal conditions which prevail in times of peace.

## Growth of Wealth in the United States

It is evident that this question is to be considered only as calling for a comparison between the inducements that will be offered by foreign opportunities and those which will be open at home. The

United States is undoubtedly accumulating wealth and increasing its means of producing wealth at a rate never equalled by any other country. The Census Bureau in its volumes upon *Wealth, Debt and Taxation*, has estimated the total wealth of this country in 1900 at $88,517,306,775, in 1904 at $107,104,193,410, and in 1912 at $187,739,071,090. The increase in the eight years from 1904 to 1912 was about $80,000,000,000 which alone is approximately equal to the total estimated wealth of either Germany or Great Britain. It is true that this includes real estate values, but the estimates of the wealth of the other countries also include real estate. Furthermore, an increase in the market value of land, while indeed not to be reckoned as a productive factor in the same sense as an increase in primary horse-power, nevertheless must be taken account of as increasing the wealth of the individual owners. It gives them the position of capitalists, places them in command of purchasing power, and makes them a more important factor in the financial world. A large part of the land values of the country are actually used as the basis of credit, and as the land becomes more valuable the indebtedness upon it increases, showing that this increment is not idle value but is put to effective use. The man who owns a valuable piece of ground can, by virtue of its value, buy materials, hire labor, erect buildings upon it and make it productive.

Moreover, the census figures for the value of real estate include all of the values that have been added to the bare land in buildings and improvements of every kind. The new buildings erected in cities where permits are required by the authorities have involved, in recent years, expenditures amounting to about $1,000,000,000 per year, as shown by compilations made by the *New York Commercial and Financial Chronicle*. These include returns for about 250 cities or an average of about 5 for each state. Besides these, there are the buildings erected in other cities, towns and rural communities and upon farms, and the expenditures upon land to make it more productive, such as clearing, draining, fencing, road-building, cultivation of orchards, etc.

The increased value assigned to "real estate" for the eight years 1904–1912 was $48,334,920,444, or about $6,000,000,000 per year. We may estimate that one-third of this, or $2,000,000,000, would represent outlays for buildings and improvements. Upon farms the improvements are relatively less, but in cities the proportion

is greater than this. In the four years from 1900 to 1904 the increase in the value of all real estate was found to be $9,803,844,463, or an average gain of $2,450,000,000 per year.

Outside of all property classed as "real estate" by the Census authorities, the country's gain in wealth from 1900 to 1904 was $8,783,042,172 and from 1904 to 1912, it was $32,300,957,236. The average per annum for the first period was $2,195,760,543, and for the second period, $4,037,619,654, certainly a remarkable showing. If the estimate of one third be accepted as representing the proportion of physical betterments in the total gain in real estate values, the aggregate of new capital created would be over $6,000,000,000 per annum for the period. This is net accumulation, as shown by the Census Bureau's calculation of values existing at the dates named, and not counting the increment upon bare land.

### This Increase Is Being Accelerated

As these figures represent the average gain per annum of the period 1904–1912, and as such gains are cumulative, the profits of one year increasing the capital of subsequent years, it follows that the gains of the year 1912 were probably considerably more than the above averages and that by this time the annual gains are more than in 1912. There are no general census figures upon wealth later than these for 1912, but a census of manufactures was taken as of December 31, 1914, the results of which have been in part made public. It shows an increase of capital invested in manufactures during the five year period from 1909 to 1914 of 23.7 per cent, which is a lower percentage of increase than was made from 1904 to 1909, but calculated, of course, upon a higher base. By the end of 1916 two years more of progress will have elapsed, and the increase of productive wealth in these two years no doubt has been greater than in any other two years of our history. It is safe to say that the net gains of wealth in the United States are now normally not less than $7,500,000,000 per annum, not including the enhancement of land values, but including the fixed improvements upon land. With the activity prevailing in 1916, the enormous excess of exports over imports, and the very complete employment of our people and our industries, the net gains of this year must be considerably in excess of this amount.

Dr. Willford I. King, of the University of Wisconsin, in his care-

ful discussion of the subject, estimated, on the basis of census reports, that in 1890 the gross income of the people of the United States was $12,082,000,000; in 1900, $17,965,000,000, and in 1910, $30,530,000,000. These increases were due in part to rising prices, but the physical equipment for production has been enlarged and improved very rapidly.

These are large figures in comparison with the estimates for other countries. The gross annual income of Great Britain was estimated before the war at about $12,000,000,000, and the annual savings at about $2,000,000,000. Dr. Karl Helfferich, in his study of the wealth and production of Germany, made in 1913, estimated the gross income of that country at 40,000,000,000 marks, or about $10,000,000,000, and the annual savings, exclusive of unearned increment, at 8,000,000,000 to 8,500,000,000 marks, or $2,000,000,000 to $2,125,000,000. He estimated the total wealth of Germany at that time at $75,000,000,000, as compared with about $50,000,000,000 in 1895.

## Can the United States Lend Abroad

It remains to be considered how much of their income the people of the United States can afford to invest outside of this country. This is still a developing country; its population will continue to grow rapidly, and this will make it necessary for a large share of its savings to be devoted to new enterprises at home. There is not, however, the same opportunity to do primary development here that there is in many other countries, and the question of how much we will invest abroad will depend for answer largely upon our inclinations. That we can spare an important amount if we want to do so is evident from what has been done since the outbreak of the war.

The merchandise trade balance in favor of the United States in the two years ended June 30, 1916, including silver, was $3,277,600,531. Foreign balances in American banks are much above normal, perhaps $300,000,000 larger. There would be, then, $3,577,600,531 in the aggregate for which the rest of the world has had, somehow, to make settlement with the United States.

The net importations of gold for the two years were $403,761,219. The balance against us on account of interest and dividends has been materially reduced since the war began, but probably has been

as much as $300,000,000 in the two years. It has been understood in the past that this income has been largely reinvested here. There have been special inducements to take it home during these years, but probably one third has remained, including what has been invested here in the foreign government offerings.

Foreign shipping charges upon American imports were estimated by Sir George Paish a few years ago at $25,000,000 per year, after making allowance for what foreigners pay to American shipping, and for the expenditures of foreign shipping in American ports. They have been greater in the last two years, probably double.

Remittances for gifts, savings and investments abroad were estimated by competent authorities before the war at $150,000,000 per year. They have been reduced, but probably have been $200,000,000 in the two years.

The expenses of American travelers, normally a large sum, may be estimated as counterbalanced by foreigners now living or traveling in the United States. These offsets, including gold, aggregate $903,761,219, and when they are deducted from the trade balance, leave about $2,700,000,000. According to the calculation this is the amount which must have been covered by loans and the return of American securities. The net amount of public loans to July 1, 1916, was about $1,100,000,000, and this would leave $1,600,000,000 to represent securities.

### Foreign Investments Here

The most definite information about foreign holdings of American securities and the amount returned to this country since the war began has been gathered by Mr. L. F. Loree, who addressed an inquiry to all railway companies with more than one hundred miles of road. The first returns covered the six months from February 1, 1915, to July 31, 1915, during which the foreign holdings of stocks, bonds and notes were reduced from $2,705,402,963 to $2,223,570,828, or in the sum of $480,892,135, par value. The second returns were for the year ended July 31, 1916, and showed a reduction during the year of $807,881,666, leaving $1,415,628,563, par value. He calculated the market value at the latter date as $1,110,099,090, and the market value of the purchases during the year and a half as $898,390,910. These figures are for railway

securities only, and do not include any held in this country at the outbreak of the war in trust for foreign owners, of which there were undoubtedly a good many. Nor do they include securities upon which payments were not being made, as ownership was traced through the income tax records. Moreover, they do not include the important amount of securities, particularly short-time notes which were paid off or re-purchased in the first six months of the war.

It has been the opinion of some people in position to be well informed that the foreign holdings in other American properties would equal the holdings of railroads, but the common estimates of them is not so high. The other holdings would include industrial securities, public utilities, municipal bonds, mining property, lands and city property, mortgages, etc. The distribution of public utilities, industrials and municipals abroad has no doubt been increasing rapidly in recent years. These investments, with a few exceptions like the stock and bonds of the United States Steel Corporation, would not, however, come home so rapidly as railroads, for the reason that they have not so ready a sale. They have come back, however, in important quantities.

All things considered, it is probable that our foreign loans and re-purchase of American interests during the last two years have been at the rate of $1,250,000,000 to $1,500,000,000 per year. This has been under conditions unusually favorable. The same exports in ordinary times would yield a much smaller trade balance. Our people would naturally rather buy seasoned American securities than they would foreign corporation issues. We are chiefly interested now, however, in determining to what extent our people have the ability to make foreign investments, and at the same time provide for the normal capital requirements at home. During the first year of the war, home demands were below normal. In the second year, owing to the high prices for equipment and construction, materials and scarcity of labor, they were below what they would be naturally in such a period of prosperity, but outside of railway enterprises the record of capital expenditures is high.

## Our Growth in Productive Capacity

A large part of the extraordinary earnings of industry in the last two years has been applied to an enlargement of capacity. This

is particularly true as to the steel industry, and in that case is directly traceable to the war demands, but nearly all lines of production have been crowded to capacity and have been putting profits back into the business. On the whole, despite high costs, our industrial growth has been kept up to the average of normal requirements, and doubtless is now exceeding them. Agricultural production does not keep pace with that of the manufacturing industries, but in the metals, for example, from the mining of iron, copper, lead and zinc, up through the conversion of the raw materials into merchantable products, the organization, plant and equipment is being rapidly developed to handle a much larger output than ever before. It is probable that by the time the war is over these industries will be in shape to supply the normal requirements of this country in their lines, and also a volume of product for export as great in quantity, if not in price value, as they are exporting now.

There may be some question about our ability to continue exporting agricultural products at the rate, in value, they have been going out during the war, but I have confidence that the work which is being done for the improvement of agricultural lands and methods will show results in the near future. If our agricultural exports are not maintained, it will be because a continued expansion of our other industrial interests makes a rapidly growing market at home.

Undoubtedly there should be very large expenditures upon our railways in the near future. A combination of influences in recent years has caused a decline in the value of railway investments, and railway facilities have not kept pace with the growth of traffic. Expenditures should be made on a large scale, with a view to the future, including a comprehensive treatment of terminals. The expenditures upon terminals will probably include large payments for land, but these do not lock up capital; only the outlays for construction involve the fixing of capital. These, although large, must be spread over considerable time; when we consider the enormous amount of work which the leading companies, notably the Pennsylvania, New York Central and some of the Pacific lines, have done in the last fifteen years, it does not seem probable that this record will be surpassed. These roads are not in need of the same outlays, but even they are crippled for want of a comprehensive system of terminals, including warehousing accommodations.

From 1900 to 1914 the capitalization of American railways, including debt, increased from $17,136,495,327 to $31,813,842,810, or at the rate of over $1,000,000,000 per year. All of these securities did not represent new capital, but in the aggregate they amount to less than the new capital expended upon the roads in the fourteen years. The premiums paid upon stock and bond issues, plus the amount of earnings expended for capital account, would exceed discounts, commissions and "water." After all of these expenditures, we have evidence that the foreign holdings of our railway securities one year ago were down to $2,223,500,000 par value.

The highest estimate by any authority upon foreign property holdings in this country was $6,000,000,000 before the outbreak of the Balkan wars. They have been moving in this direction ever since, and at this time $3,500,000,000 par value would be a liberal estimate. It is safe to assume that if the war continues another year, our loans and investments abroad will equal or exceed foreign interests in this country. This will mean that there will be no balance against us on account of interest and dividends.

### A Shortage in Labor Supply

The pace at which we can go forward with construction work in this country is limited by the available labor supply. Our supply of capital is increasing very much more rapidly than the supply of labor, and the effect is largely spent in an increase of wages and prices. When everybody already has employment, competition among employers attracts labor from one factory to another, or from one branch of industry to another, but except as stimulus is given to the introduction of labor-saving methods, and as labor is concentrated where the returns are highest, production is not increased. The industries of the cities have been attracting labor from the farms with the result that the cost of food is made higher for all. Obviously there must be a limit to this movement within a single country. The competitive field will broaden out to include other countries. As the cost of production rises here, the inducements for capital to find employment in other countries will be greater. If there is not labor enough here to man the new capital supplies, there is Russia where a vast supply of labor exists with a scarcity of capital; and China, where the situation is even more one-sided. The economic gains from the use of capital usually

diminish with the higher development of industry, because the fundamental changes come first; they accomplish more at a stroke than do the improvements upon them. It is only as capital becomes cheap that it pays to lower the railway grades and straighten the curves as we have been doing in the United States since 1898. These are the considerations that will determine whether we shall go on making vast capital investments to accomplish small savings at home, or send a share of our new accumulations to the more backward countries, where the economic results are greater. In the United States, according to the census of manufactures for 1914, the total number of persons engaged in manufactures was 8,265,426, and the total amount of capital employed was $22,790,-880,000 or $2,787 to each person. No other country has such a capital equipment; no other farmers in the world have as efficient implements to work with as the farmers of the United States. We have an all around equipment superior to that of any other country.

There is a sense, of course, in which we can always use all of our capital at home. This will be so if we are indifferent to the rate of return. If the returns are as good at home as abroad, nobody will advise going abroad. But with capital increasing faster than population, the law of diminishing returns is constantly operative, and the accumulations available for investment will decline until they are in equilibrium with the home demand. On the other hand, a people who go abroad for advantageous investments, and give a hand in developing the efficiency and wealth of other peoples, will find their own industries stimulated, and actually have more capital to invest both at home and abroad.

## CONCLUSIONS

I would repeat, then, that this question, whether we are in position to make extensive investments abroad is one of comparative opportunities and cosmopolitan education. We have ample capital to allow of our making extensive investments abroad. Our own capital equipment is greater per head than that of any other country, and naturally there are larger profits to be made in building up the equipment of others than in increasing our own. The chief obstacle to our making investments abroad is the lack of experience in foreign operations. We are not accustomed to distant investments. Even at home our investments are chiefly local. We have spread out

over a great country, every part of it has been developing, and there have been many opportunities for local investment.

Land with the improvements upon it has furnished the principal outlet for savings. The average investor in this country likes to be able to walk around and survey his investment occasionally. Considering the wealth of the country, the distribution of stocks and bonds among the people is not what it should be. Our financial fabric would be safer if bank deposits were less and the investments held by the banks were held by the people direct, but this statement must be qualified by adding, provided the people are qualified to select sound securities. An enormous amount of capital is lost annually in wildcat and blue sky schemes, because people are impatient of small returns and unable to discriminate among the investments offered. The popularity of land investments frequently causes inflated prices, with losses resulting. This country's ability to absorb securities would be enormous if the great body of the people was educated to that class of investments, and acquired the habit of buying them and saving for them.

Our ability to increase our foreign trade depends largely upon our willingness to assist our would-be foreign customers in their development. If we will build railways in South America, or China, and take stocks or bonds in payment, we can have all of that kind of work we want to do for years to come, and have the subsequent orders for locomotives, cars, and other equipment and supplies. But the contractors and manufacturers cannot take these securities in payment for their work. They must have money to pay for the labor and other costs. The American investor must do for our manufacturers what British and German investors have done for the manufacturers of those countries; they must accustom themselves to foreign enterprises and make a world's market for securities.

It goes without saying that this cannot be done in a day, or a year. Nobody would advise the American investor to rush out, fired by a patriotic impulse, and buy the first foreign bond that is offered. The business must be handled with exceeding care, and only upon personal knowledge or through experienced and responsible agencies. There is not the slightest danger that the business will grow so fast as to restrict necessary American investments. There is no probability that our foreign investments will increase

fast enough to take up even ten per cent of our increasing capital accumulations. Argentina has been growing faster than all of the rest of South America, and total capital investments in Argentine railways since 1900 have averaged only $48,000,000 per year. If Mexico was a safe field for investment, capital would flow over the border like a flood, and its movement would give such a stimulus there and here, and the two countries would react upon each other so rapidly, that we would never miss what we sent. Cuba, under the benign influence of the Platt amendment, is receiving such a flow, and the benefits are mutual. The difference in capital accumulations when our industries are driven to capacity as at present, compared with the gains of ordinary times, would be enough to put us in the first rank of lending nations.

## THE RELATION OF GOVERNMENT TO FOREIGN INVESTMENT

By Huntington Wilson,
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The relation of government to foreign investment by its citizens is one of correlative obligation and authority, general obligation to protect the citizens' rights, and authority to control the citizens' course by giving great or little protection, or none at all. In the discharge of its obligation the duty of government is to measure the protection to be given any investment first of all by the advantage of that investment to the nation; and secondarily to mete out that protection in proportion to the right of the investor to expect protection.

The authority correlated with the obligation to protect is that involved in the power to vary, in accordance with the criteria above cited, the degree of protection, if any, to be afforded in the case of a given investment. Without any legislation on the subject, the government's authority is automatically of determinative potentiality in this question of foreign investment in all countries except those of the highest credit and stability. And even in the case of such countries, an adverse intimation from Washington would tend to have a blighting moral effect upon a proposed investment of American capital.

From the days of the struggles of Phoenicians, Carthaginians, Greeks and Romans in the Mediterranean down to today, it has been power, and above all sea power, which alone has protected foreign trade. Even in these allegedly softer times, we must admit, now at least, that it is only under the shadow of the great powers, those prepared or potentially able to use great power, that small countries like Belgium, or even relatively weak, although great, countries can, as independent nations, carry on a big foreign trade. The governmental relation to foreign investment in its authority and obligations presupposes and demands power.

THE RELATION OF THE GOVERNMENT TO FOREIGN ENTERPRISE

For the purposes of this discussion, we shall do well to consider the relation of government to foreign trade and to all sorts of foreign enterprises, as well as to investment in the narrower sense of shares and bonds, because the same principles apply to all alike. It may at first sight seem an extreme view, but one may go farther and apply similar general principles even to the relation of government to the presence of its citizens to reside for any purpose in any part of the world.

The relation we are considering is one to be dealt with by the diplomatic department. Like other questions of real and statesmanlike diplomacy, this question derives its importance and its charm and interest from its farspread ramifications and concatenations. It carries into the far future and it brings many sciences out of the "conference stage" to an entirely practical application in every day international business. Here, as elsewhere, diplomacy becomes everything that concerns one's country, fostered through its foreign relations.

During the four years preceding the present administration, when Mr. Knox, as Secretary of State, gave a new definiteness, intelligibility and practicalness to American diplomacy, the policy toward foreign investment was epitomized thus: "The Department (of State) will give all proper support to legitimate and beneficial American enterprises in foreign countries." This formula was the invariable answer to the prudent investor desiring to know in advance what would be done for him if, through no fault of his own, he got into trouble, due, say, to oppression or failure to protect on the part of some foreign government.

Now the government's obligation to protect a particular American interest abroad must, in its discharge, be measured and meted out, as has been said, in proportion to the benefit of that particular interest to the nation as a whole. Whatever influence or force the government may exert in the world is the prestige and power of the nation. Consider this collective power, moral or physical, as a great reservoir. The executive branch of our government has constitutional authority to conduct foreign relations untramelled except by the authority of the Senate when it comes to a treaty, by the authority of the whole Congress when it comes to an appropriation of money, and in some few other respects. This authority is so

appallingly broad, one may remark, that it becomes of vital necessity that the United States should have fundamentals of foreign policy that are accepted by the whole nation, to be permanent bases of action in all specific questions of importance. Otherwise the American people can be involved by the executive without referendum in any folly during every four years between presidential elections. Even party platforms about foreseen questions are no safeguard, for we see them violated, as in the Panama Canal tolls question with Great Britain. Now this startling breadth of executive authority in diplomacy places the executive, as trustee of the nation's international influence, under obligations of the greatest solemnity and weight. Therefore how much thought must the Secretary of State take before turning the tap of the reservoir and drawing off for the protection of a foreign enterprise a measure of the national prestige and power entrusted by the people to his care!

## "Dollar Diplomacy"

This theme and its illustration by example lead to an exposition of what has been called "Dollar Diplomacy." It might better be described as common sense diplomacy, in contradistinction from the diplomacy of perfunctoriness or that of whimsical sentimentality from which the United States has suffered so much. It is submitted, moreover, that one who will carefully study the so-called "Dollar Diplomacy" will be fully convinced that it was a diplomacy of common sense in the highest sense of that term, that is, a diplomacy determined by the application of scientific principles and sound thinking to plain facts studied and understood as they really are; a diplomacy preferring to build for the long future, rather than to dogmatize for the moment's expediency; preferring the truth to a beautiful idealization not resting upon truth.

Now the national advantage of a foreign investment may consist in (1) political advantage or (2) economic advantage. Service to humanity is not mentioned separately because charity begins at home; because it is America's first duty to serve America; because America, as a government, can amply serve humanity in spheres and in ways in which America also serves itself; and because if it does that, the service to humanity may be considered by diplomacy, which is not, by the way, an eleemosynary institution, as merged in the service of America, that is, in American political advantage.

Those who dissent from this view and yield to our national foible for grandiloquent sentimentality ought to reflect that a trustee, however admirable his private charities, would be put in jail if he used trust funds for benefactions; and that exactly so the American executive defrauds the nation if he uses its prestige and power in a diplomacy directed by sentimentality to the service of humanity in general, instead of a diplomacy seeking the political and economic advantage of the American taxpayer, the American nation.

### POLITICAL ADVANTAGES OF FOREIGN INVESTMENT

Political advantage (1), then, comprises such factors as (a) strengthening American influence in spheres where it ought to predominate over any other foreign influence on account of reasons of fundamental policy, like the Monroe Doctrine, or of military strategy or of neighborhood. Such a sphere is "Latin America," where our interest increases in intensity from a vanishing minimum at Cape Horn northward to reach its maximum in the zone of the Caribbean Sea, the neighborhood of the Panama Canal, and in Mexico. In this category falls also, for example, the discharge of our historic obligation to Liberia and the preservation of that little country as a *pied-à-terre* in Africa, of possible potential value to us for commerce or for the emigration of African Americans. Such political advantage ranks highest. Next comes (b) the maintenance of a traditional position favorable to our trade where trade may go by political favor, as in the Chinese Empire. Other cases of political advantage would be (c) the strengthening of our friendship with other great powers, or (d) with countries where it is wise to preëmpt a share in a dawning development, like Turkey, or (e) with countries whose markets are especially valuable. The cases merge so gradually into one another as to make clear cut classification difficult. This is true also of the division of political from economic advantage. The idea is that in some cases trade is important primarily for its political effects through mutual interest and association, while in others a good political relation is valued (if not for safety and advantage in actual coöperation or alliance) for its tendency to favor trade. The student of American diplomacy will readily enough place our relations with different countries in appropriate categories even without an attempt at nicer classification than is here intimated.

THE ECONOMIC ADVANTAGES

Inasmuch as political advantage comprises whatever touches national security, the first place in importance, among economic advantages, must be given to (a) those investments or enterprises which most promote vital political interest. Next most important in economic advantage to the nation and usually identical with (a) are (b) foreign investments or enterprises which establish permanent and valuable markets for trade while at the same time subserving political strength where the policy of this country demands that it be strong if we are to have security and tranquility. Other cases are (c) investments or enterprises which have these same purely material advantages while carrying with them some political advantage as well, as, for example, in safeguarding our Chinese trade; or (d) those investments or enterprises which serve in giving us a commercial standing in some valuable market where development may be preëmpted by others if a footing be not early obtained (like Turkey); or (e) in cementing friendship with our natural allies, as Canada and the English speaking peoples generally; or (f) in bringing profit and employment to the American people in general.

In the encouragement of foreign enterprise, diplomacy must beware of forcing it into spheres where vexatious conflict with the special spheres of influence and interest of other countries outweighs all commercial gain to be looked for. Every great power has some "doctrines" that it conceives to be as vital to it as the Monroe Doctrine is considered here. Korea and Manchuria, Persia and Siam, come to mind as examples of territory where, while conducting ordinary trade, we should be wasting our energies to attempt intensive developments. In return we should gradually crowd out from our own sphere of special interest foreign interests wherever they are predominant to an uncomfortable extent and quite beyond the requirements of an ordinary trade outside the spheres of special interest of the foreign governments concerned.

Quite aside from this common sense circumscribing of our spheres of greatest effort to make them comport with the facts of world politics, it is still true that there is not enough American capital yet available for foreign investment thoroughly to cover the duty of consolidating our economic position in the spheres where that necessity is most obvious. Also, there is a lack of men trained for this work and willing to reside under tropical rain, amidst moun-

tain peaks, on broad savannas, and in ancient cities of manners and ideas quite alien to our own, in order to carry it on. "God gives a man his relatives; he chooses his friends." A nation is less fortunate. The hazards of history have made us a sphere of vital interest which we have to cultivate, however difficult it be.

### PROPER SUPPORT TO LEGITIMATE ENTERPRISES

Let us return to the formula. "The Department (of State) will give all proper support to legitimate and beneficial American enterprises in foreign countries." A legitimate enterprise must be honest and fair, and just to the foreigners concerned. But it may be legitimate so far as the interested American is concerned and beneficial to him individually while not beneficial to the nation. Such would be the case if the dangers of seriously involving this country in fresh obligations outweighed any national advantage; if the investment diverted from channels of real national advantage money that might otherwise serve that advantage either abroad or at home; or if the project involved offending a valued friend among the nations. To merit the strongest governmental support, the foreign investment or enterprise must be really beneficial to the nation.

In the formula, the phrase "all proper support" is advisedly indefinite. The Secretary of State must reserve the question of how much support will be "proper" in a given case, because when the question is asked it is a hypothetical one; because the question will be a political question, to be affected, perhaps, by changing conditions; and because, above all, it will be one involving the careful consideration of subtle measures of national advantage,—which is the first measure, as the citizens' right is the second measure, of the government's support. The government's obligation is its duty to the citizen, but the coefficient of that duty is its duty to the nation.

Proper support is the discharge of the government's obligation, limited by its variant authority or power, expressed in terms of action, diplomatic, or in the last resort, warlike. And that proper support is the duty to the citizen plus or minus the sum of political and economic national advantage.

This almost mathematical expression of the theory of "Dollar Diplomacy," to use the approbrious nickname, may assist a clear

understanding of a subject deplorably little considered by our countrymen. Illustration, however, will perhaps supply vividness to a dry statement.

### APPLYING "DOLLAR DIPLOMACY"

Without law, it is of course only where the citizen thinks he may ultimately need his government's help to "pull his chestnuts out of the fire" that he can really be controlled. He will buy Anglo-French bonds in full faith in the honor and stability of Great Britain and France. If he jumped into a pet private preserve of Great Britain or France and engaged in enterprises subversive of some policy of "protection, guidance and control" (to quote the classic of Japanese aggression in Korea), it is not intended to imply that his government would abandon him to his fate. It would seek equitable damages for him, but probably not specific performance. So it was, in principle, to give an analogous example, when the American advisers were forced out of Persia by Russia and England. American influence in Persia was of no account to our national interest. An equitable adjustment doing justice in a general way to our citizens, would in such a case be proper policy. If, on the other hand, those advisers had been in a country where American influence was of national importance, the American government must have resisted their dismissal and insisted upon specific performance, although the contracts were no more binding in the one case than in the other.

The convention with Santo Domingo, the agreement with Cuba involving certain public works, the convention of 1911 with Honduras (rendered abortive by the vote of an adverse party majority in the Senate), the old arrangement and convention with Nicaragua, carried out after a fashion by the present administration, the loan policy with China, which the present administration promptly killed and now has made an unsuccessful effort to resuscitate,—all these involved foreign investments of such great and unquestionable national advantage that the government was an active participant in them; and, by urging on the investors to lend themselves as instrumentalities of foreign policy, the government clothed those investors with rights to protection of especial dignity.

Since this is not a discussion of American diplomacy at large, but is confined, so far as practicable, to one phase of that subject,

those transactions need not be described at length. Suffice it to say that the object of the Central American policy was "to substitute dollars for bullets," to create a material prosperity which should wean the Central Americans from their usual preoccupation of revolution. Those countries have great natural wealth. Lack of capital, lack of skill, and still more the absence of any guarantee against confiscation and destruction due to the frequent revolutions when law and order are thrown overboard, prevent the development of their natural wealth by the people themselves. The same conditions throttle their export trade and destroy their purchasing power. Attacks upon American interests, and even upon the personal safety of American planters and others engaged in those countries, call for our government's protection. The similar jeopardy of European interests demands, as an unavoidable corollary of the Monroe Doctrine, the protection of the American government. For the frequent interventions, moral or physical, thus necessitated, we had no convenient base. With great pertinacity certain far away European powers, with an effrontery engendered by the inchoate state of American foreign policy, have been at great pains to poach upon our preserves in the Caribbean and even on the Isthmus itself. In Central America, as in Columbia in theory, there was the question of an alternative inter-oceanic canal route, and that was a basis inconveniently open for the preëmption of a special interest which we could not afford to see go to others than ourselves. Trade with Central America was retarded by the lack of railways and by financial instability. The ports of our southern states, the logical centers of this rich trade, were being deprived by those adverse conditions of a profit due them from the facts of geography. It is true that one or two of the republics of Central America are in far better condition than the others. To cite a case where the political and economic advantages are both of the first rank and where, therefore, the measure of governmental support should be at its highest, I will refer to the policy toward Nicaragua, which illustrates only more completely what should be the spirit of our policy throughout the zone of the Caribbean. Indeed as now implemented our policy in effect is the same in principle in Panama, Cuba, Santo Domingo and Haiti.

### Our Policy Toward Nicaragua

In Nicaragua a New York bank of the highest standing was induced to invest in the financial rehabilitation of the country, its transactions giving it an interest in the railways and in the customs revenues, which it is always desirable to remove from the reach of revolutionary depredations. Americans were engaged as financial advisers, as claims commissioners and in other important capacities. A convention was signed to give the United States a naval station in the Gulf of Fonseca, dominating three of the republics. A perpetual option upon the Nicaraguan canal route was assured us. A large sum of money was to be advanced Nicaragua for its most pressing needs, but to be expended only under American supervision. The full fruition of this plan was postponed by partisan opposition in the Senate, but it was later taken over, in a general way, by the present administration and may now, it is hoped, meet a kinder fate. An outstanding feature of this particular policy is its effort to help our neighbors to help themselves and to do so in practical ways, which advance at the same time the very real and quite legitimate and indeed the inevitable interests of our own country.

The Nicaraguan arrangements are so comprehensive that they serve to illustrate many phases of the same policy we have seen pursued in Cuba, in Panama, in Haiti, in Honduras. The public revenues, especially the customs dues, must be placed out of reach of the revolutionary robber or the dictator. Capital must be brought in to establish peaceful husbandry and unmolested industry. Education and civilization must bring justice. A guiding hand must prevent foreign entanglements, which, under the Monroe Doctrine, straightway involve us. Even if the Monroe Doctrine had never been announced, common prudence would today force upon us the same policy from our southern border throughout the zone of the Caribbean.

### The Law of National Survival

No far seeing policy, but a natural human movement, accounts for the vast American investment in Mexico and for the penetration of thousands and thousands of Americans into Mexican territory as planters and miners and workers. Here a natural law and a political theory work together, as is the case whenever the political theory is sound. There are so many analogies between biology and inter-

national evolution that one may invoke a sort of "international biology." The march of civilization brooks no violation of the law of the survival of the fittest. Neighboring countries comprise an environment. The strongest will dominate that environment. Sentimental phrases about the sovereignty of weaker countries will no more permit them to run amuck with impunity than ranting about individual rights will permit an outrageous citizen to annoy a municipality and escape the police. The biological law of the tendency to revert to the lower type as the higher attributes are disused is at work among nations; and nature, in its rough method of uplift, gives sick nations strong neighbors and takes its inexorable course with private enterprise and diplomacy as its instruments. And this course is the best in the long run, for all concerned and for the world. The murder of two or three German missionaries in far-off China, cost China Kaichow and practically a province. The murder of many Americans in nearby Mexico, where by every law of neighborhood and policy they had a special right to be and to be protected, has cost Mexico so far—the reading of a great many communications. Life is priceless; but what of the investors, great and small? Here is a case where political and economic advantage to the nation are at a high level, where the government's obligation to protect connotes a great degree of support as proper. This is so because no field of investment is more natural than that over the border, which fact gives the citizen the right to expect support, subject to the national interest concerned, in this case a high coefficient. If so much be granted, the support, it has been said, is limited by its (the government's) variant authority or power. Since no one doubts its power, our government's task then becomes one of ways and means, with the evident duty of sparing so far as possible our own blood and treasure. The seizing and holding of revenues amply to cover all actual damages at once suggests itself as a practical measure and one readily assimilable with the chastisement and chastening due from us if we do not repudiate the duties imposed upon us in the nature of things by laws as real as those of biology.

This digression is perhaps excusable as anticipating the question of ways and means of protecting foreign investments and enterprises in various cases which differ as widely as the one just described differs from an economic question with a first-rate power. There,

too, we bungle and are unprepared. We lack the weapon of a sliding-scale tariff, with discretion in the Executive to force justice to our interests by the threat of effective and prompt retaliation.

### The Six-Power Loan Policy in China

The six-power loan policy in China is in point upon this question of how the government would protect its citizens' investments. Aside from the high repute of the Chinese people for commercial morality, what with the turbulent conditions of the Empire and its distance from us (except in the Philippines) one might say that the American government could ill afford to undertake to protect its citizens in great investments there. In China we have a traditional position of friendly concern and a commerce that once promised very well. But we have not the political mandate of a cardinal principle of policy nor the natural mandate of neighborhood as we have in Mexico.

Mr. Knox "pooled" our interests in vast railway constructions and currency reform, involving huge investments of capital, with the interests of five other great powers. In this way, America secured its share in those lucrative undertakings while its share of responsibility in protection was only one-sixth of what it otherwise would have been.

Let us further examine that Chinese policy which the present administration in a heat of partisanship so ruthlessly reversed, to learn later, as it did in respect to a number of other matters, that foreign policy is not domestic politics. We may be our "brother's keeper" in the case of Mexico. We are certainly not China's keeper. I do not therefore attach to the purely political aspects of our Chinese policy quite the same importance that some do. There is working in the Far East an "international biology" that we have neither duty nor interest in radically interfering with. Times have changed since Mr. Hay expressed in idealizations about the "integrity" of China the good will America had always felt for that Empire. However, we wanted and we still want the "open door" of ordinary equality of commercial opportunity. Before showing how Mr. Knox's policy served those practical ends, the political aspect may be touched on, although it is rather one of sentiment than one related to a policy of the first class that a nation would fight alone for.

Naturally enough, Russia and Japan have designs upon outlying Chinese territory and certain Chinese provinces. Manifestly, to concatenate great interests of theirs with great interests of four other powers preferring to preserve China pretty well intact would tend to create a community of interest in the preservation of China's integrity. If two men with certain intentions were chained to four men with other intentions, the course of the group would differ from the untramelled progress of the first two men. Thus, without any offensive or radical interference with other nations' natural expansion, the United States, with Great Britain, France and Germany would have had a share in the first practical arrangement ever suggested to work with any effect along the lines of the rather illusory declarations of Mr. Hay.

### Significance of the Knox Policy toward China

Turning from this now more or less chimerical consideration, we note the really brilliant statesmanship of Mr. Knox in placing us, with no danger and with only a small share of responsibility, and that divided with powerful partners, in a position not only of dignified equality, but of actual leadership in the large concerns of the Chinese Empire! To realize how important that rôle was to our general Chinese trade one must know China. Besides indirect effects, the Chinese arrangement gave us such economic national advantages as these: American engineers would be appointed and American railway materials would be used on our proportional part of the whole railway system. That meant money to American industry. As to the bankers' profits in the loans and the ultimate bondholders' income, they were good for the country too, economically, but were so clearly a means to a greater end that the bankers had to be urged into the whole transaction and, during its difficult course, often urged to remain interested. If this had not been done, and if American bankers had not responded with a good deal of patriotism, the biggest transactions ever undertaken in China would have proceeded without the least participation by the country which had officially talked most of China's opportunities.

Reference to the direct economic advantages to the nation to be found in the railway loans to China brings us to a few last comments upon the measures of economic advantage in foreign investments. Lately a gentleman prominent among those who are at

last making a campaign for foreign trade spoke of Russia as a great field for American enterprise and in doing so spoke particularly of the opportunities for branch factories. Now this question of "extraterritorial enterprise" is a familiar one to the practical diplomatist. A branch factory in a foreign country may be very profitable to the capitalist, and it will be better than nothing in so far as it brings money into the United States; but it does not directly pay American wages or enrich and build up American communities, as do great foreign orders to be executed in American factories at home. Therefore the foreign branch factory is of relatively slight national advantage and has relatively small claim on the benevolent interest of the government. Such, by the way, would not be the case of an American factory established where it was especially desired to strengthen the national influence, particularly if the factory was not in point-blank competition with a home factory and in that way deflecting wages from Americans to cheaper foreign labor on the spot.

## THE GOVERNMENT SHOULD GUIDE FOREIGN INVESTMENTS

The necessity of having our exports paid for ultimately in goods or securities (and not always in gold) makes it of interest to the government to encourage investment in certain countries. We cannot, for example, buy the coffee crop of all Latin America. Indeed to encourage here, to deter there, in short, more or less to guide foreign investment, is a proper function of government. There should not be obligation without authority. The value of our home investments rests, in the last resort, upon our municipal law. The value of our foreign investments rests, in the last resort, upon our diplomacy, the conduct of our foreign policy. The efficacy of these depends upon our prestige and our military power, and these last are the possession of the nation.

There would thus be a logic in a requirement of official permission to list foreign securities in our markets or to undertake certain foreign enterprises. For the exercise of this discretion we should need a little law. It might be vested in a small committee, for example, of competent officials of the Department of State, of the Treasury and Federal Reserve Board, with the Chairmen of the Foreign Relations and Foreign Affairs committees of Congress.

It seems, after the question has been mooted for years, that

we still need a law (perhaps!) to keep the Sherman Anti-Trust law from frightening our manufacturers and merchants out of their right to combine to compete with Europe in foreign commerce. Only now have our laws a little helped our bankers to establish themselves abroad and to give our trade and enterprise the needed facilities. We are very backward in foreign affairs, commercial, financial, and political, and disposed to neglect all that hard ground that lies between great visions and small details. The end of the war will leave with the problems of foreign investment and enterprise and the government's relation thereto a new urgency. And laws or no laws, if we are to deal wisely with them, the realities of American diplomacy must become matters of conscious concern and intelligent interest to American citizens. Only so can government be compelled, under our system, to perform its task of leadership, to make effective its proper relation to foreign investment and enterprise.

# DOLLAR DIPLOMACY AND FINANCIAL IMPERIALISM UNDER THE WILSON ADMINISTRATION

By Frederic C. Howe,

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Dollar diplomacy is the name by which overseas expansion and financial imperialism have come to be known in the United States. It was first consciously promoted during the administration of President Taft by Secretary of State Knox, who entered into treaty relationships with Central and South American states for the promotion of American trade and finance to which was lent the active support of the state department and the diplomatic service. But dollar diplomacy is only incidentally a trade policy. It is primarily a financial policy. And if we may judge by the interests promoting dollar diplomacy in the United States, as well as the forms which it has assumed in England, France, Germany, Russia and Japan, trade as such is merely a guise for financial exploitation.

Financial imperialism or dollar diplomacy seems to me to be the gravest menace before the American people. Underneath other issues it is the paramount issue in the present campaign. It not only involves the ending of the splendid isolation of the United States from questionable relations with other peoples; it involves the conversion of the state department and the army and navy into collection and insurance agencies for Wall Street interests, concession seekers, munition makers, and those who would exploit weaker peoples under the philanthropic assurance of promoting their development.

## Ruinous Demands in Six Power Loan to China

The most noteworthy instance of dollar diplomacy was the Chinese six power loan; a loan which was negotiated by China under duress. She needed $30,000,000 for the rehabilitation of her finances and sought this sum in the financial markets of Europe. China found all avenues of aid closed against her except certain favored banks in each country which had the exclusive support of

the home government. Attempts to make the loan from independent bankers on reasonable terms were blocked by the respective foreign offices. Ultimately China found that she could only borrow from a syndicate of favored English, German, French, Russian, American and Japanese bankers, who formed the six power loan. They exacted ruinous terms. They refused to make a loan of $30,000,000, and insisted (according to the best reports obtainable) that China should borrow $300,000,000, or ten times what China needed. Now the financial integrity of the Chinese people is above question. A loan of $30,000,000 could easily be carried by that nation. The reason the banks and the countries back of the banks insisted upon an excessive loan was that it then became possible to exact conditions which would not have been possible under a loan of a smaller amount. And these conditions involved the political integrity of China. They involved an invasion of her sovereignty. The lending powers insisted that China should turn over the expenditure of the loan and the administration of the salt monopoly to European control.

A further reason for the big loan and these exactions was the expectation that China could not meet the interest on such a loan and that her territory would be divided into spheres of influence in each of which one of the lending countries could make use of the closed door to keep out all other nations in the exploitation of the resources, railroad building and trade of the territory. For the closed door, the exclusive concession, ending with a protectorate, is one of the inevitable corollaries of dollar diplomacy. The exploitation of the resources of the country, as well as the people themselves, is far more profitable than even the making of loans, no matter how usurious the terms of the loans may be. And China's finances were in a bad condition. There was danger that the annual charges of $42,500,000 on the foreign debt would not be met. In addition indemnity payments were in arrears to the amount of $15,000,000. With an added debt of $300,000,000 it was not improbable that China might go bankrupt, especially as the control of her tariffs and internal revenue systems were all to be placed in the hands of representative of the bankers who made the loan and who if we may judge by Egypt, Tunis, Morocco and Persia, were not disinclined to see China go bankrupt.

## CHINA'S PROTEST TO OUR GOVERNMENT

The United States was represented in the six power loan through a group of New York banks which claimed to have been encouraged by the Taft administration to participate in the loan. That such encouragement was given was indicated by the J. P. Morgan Company after President Wilson had suggested the withdrawal of the American group from the six power loan. This action of President Wilson was in response to a protest from the Chinese government, which said that it could not assent to the exactions and usurious terms, as well as the invasion of the soverignty which the six power loan involved. This action of disapproval was taken by President Wilson almost immediately after his inauguration in office in 1913, the loan having been negotiated during the previous year.

As a result the American bankers withdrew from the loan. They have ever since protested against the action of the administration. China, however, freed from the cordon of powers which was drawn about her, was strengthened by the action of President Wilson and succeeded in negotiating a loan that was more favorable than that originally proposed. She finally succeeded in placing a loan of $125,000,000 in April, 1913, into which group Japan and Russia were admitted for political reasons. Under the terms of this loan the control of China's affairs by European agents was modified by the appointment of "advisers" to direct the expenditure of the loan and to supervise the revenues of the country. A British representative was placed in charge of the salt monopoly; French and Russian advisers in charge of the audit department; and a German adviser of the loan department.

For four years representatives of the powerful financial institutions of New York, comprising J. P. Morgan and Company and the Standard Oil group, have been quietly and openly protesting against the refusal of President Wilson to identify the state department with overseas finance. The demand is not made in such bald terms, for the American people would not sanction the use of the agencies of the government as a collection and insurance agency for Wall Street interests. Yet stripped of accessories, that is all that dollar diplomacy means. It means that the American banker, concession seeker and exploiter shall be permitted to negotiate any kind of a contract and once the contract is secured it shall have back of it the strong arm of the government to enforce its terms. If revolu-

tions break out that threaten the investment, if the interest is too heavy to be paid, the army and navy shall be dispatched to suppress the revolution or bring about a government selected by the financiers to insure their investments; for foreign loans and concessions are accompanied by treaties. Treaties are part of the contract of borrowing. And under the treaties the borrowing power guarantees the investments and by implication authorizes intervention by force, if necessary, to validate contracts, if it is unable to insure them itself.

### The Origin of "Dollar Diplomacy"

European international law now sanctions this right of a lending nation to interfere with the internal affairs of the borrowing nation. It is a doctrine first formulated by Lord Palmerston of England about the middle of the last century in connection with the claims of a Portuguese Jew who said he was a British citizen. Loans had been made by him to Greece. Their terms were not met, and British gunboats were sent to Greece to insure its payment. This was the beginning in modern times of the doctrine that the flag follows the investor; that the strong arm of the government may be used for policing weaker countries that fail to meet their debts. It has since been accepted as a doctrine of international law by England, France, Germany, Japan and all of the greater powers, and has been used to the limit to bring defenseless people under the subjection of the creditor nation. This is the ultimate meaning and inevitable consequence of dollar diplomacy as demanded by the financial interests of America. Some of the consequences of this policy will be referred to later.

The President's disapproval of the Chinese loan was accompanied by a statement that the administration would not sanction it because it "did not approve the conditions of the loan or the implications of responsibility on its own part which it (the administration) was plainly told would be involved in the request." "The conditions of the loan," said the President,

> seem to us to touch very nearly the administrative independence of China itself, and the administration does not feel that it ought even by implication to be a party to this condition. The responsibility on its part which would be implied by requesting the banks to undertake the loan might conceivably go to the length in some unhappy contingency of forcible interference in the financial and even political affairs of that great Oriental state.

### THE REAL SIGNIFICANCE OF THE WILSON POLICY

President Wilson's administration has drawn a definite line of demarcation between trade and commerce as such and dollar diplomacy. And there is a very distinct difference. The administration has said that it will do everything in its power to obtain equality of opportunity for Americans in the development of foreign trade and in the promotion of American commerce. To this end consular and other agents may be employed. But it has insisted that nothing shall be done that interferes with the sovereign rights of other governments to regulate their own internal affairs. President Wilson has insisted on the inherent right of weak and struggling peoples to work out their own internal problems free from coercion or intervention by the American people. The administration has refused to assume responsibility for, or to guarantee the financial obligations of, weaker states in their dealings with American capitalists. And the department of state has insisted that it will exercise its own right to decide each case independently as it arises and upon its merits, always with the understanding that this government is under no obligation to interfere by force or by menace of force in the financial or political affairs of other countries.

The refusal of the United States to sanction financial imperialism goes back to the famous Drago doctrine enunciated in 1902 at the time of the attempts of European powers to coerce Venezuela. The Drago doctrine is to the effect that a public debt carries with it no right of armed intervention or of the occupation of territory in North or South America by any foreign power. This doctrine was subscribed to by Elihu Root, then Secretary of State. It was later accepted by the Hague peace conference in 1907. Yet such acceptance has in no way interfered with the aggressions of foreign powers in other countries than those protected by the Monroe Doctrine.

Mr. Willard D. Straight, formerly of the firm of J. P. Morgan & Company, and at the present time connected with the American International Corporation, has challenged this doctrine on several occasions; and inasmuch as he has assumed to speak for the financial interests, his utterances are authoritative. In a speech before the National Foreign Trade convention in Washington he said:

> I think we will see a time when the government will stand behind foreign loans; when it will be recognized that the government is the great coördinating

power which shall bring the banks and manufactures and the public together; and will announce that it will support such and such a loan so long as it realizes that the proceeds thereof are to be used for the benefit of American industry.

### ENGLISH FINANCIAL CONQUEST OF EGYPT

All this sounds very patriotic and reasonable. It is a policy to which American trade and business would generally subscribe. There is every reason, it may be said, why the government should encourage overseas finance. The declarations of the financiers of England, of Germany, of Russia and for France were probably just as patriotic and just as defensible as these. Yet the history of the world during the past thirty years is full of the most brutal crimes committed in defense of this doctrine. Since 1880 over 100,000,000 people have been made subject to Great Britain, France and Germany alone at the dictation of overseas concession holders and financiers who paraded the flag of their country and the doctrine of Lord Palmerston as a justification of their claims. Millions of miles of territory have been seized, and with the exception of China and South and Central America practically every spot on the globe has been placed under the control of the financial interests of Europe. The process began in 1882 with the occupation of Egypt, into which country England went, according to Lord Cromer, at the insistence of the financiers. Egypt was loaded with debt. A spendthrift Khedive borrowed money at usurious rates. An indebtedness in excess of $400,000,000 was created in a few years' time out of which unhappy Egypt received only $100,000,000. The rest was kept for commissions, securities and other profits of the bankers. The interest on the debt became insecure. The natives were crushed by oppressive taxation. Finally when further taxes could not be squeezed from them, Alexandria was bombarded and Egypt occupied. Such was the motive of the English conquest of Egypt. It is set forth in state papers, and is portrayed at length in a remarkable book entitled *Egypt's Ruin* written by Theodor Rothstein.

### FRANCE, GERMANY AND RUSSIA FOLLOW SUIT

The example set by Great Britain in Egypt became the model of France, Germany and Russia. The unhappy exploitation of Morocco by the allied powers nearly brought on the European War in 1911. Morocco was a free state. She was governed by a weak

and spendthrift prince. The bankers of the allied powers forced loans upon him and increased the indebtedness of this state from $4,000,000 to $32,000,000 in seven years' time. Colossal commissions running into the millions were taken on these loans by the bankers. The loans were accompanied by concessions for mines, railroads, docks, and all of the profitable industries of the country. The revenues of the state were placed under the control of foreign advisers. The taxes were used to pay interest on the loan. Finally the Sultan was only able to meet his needs by crushing taxes on the peasants. The peasants protested. The protest was magnified by the financial press of France into a revolution. It was said that foreigners were being butchered by the Moors. France sent an army of intervention. The country was occupied. Fez was captured. The closed door against other countries was adopted by France. Germany protested and sent the "Panther" to Morocco. England then joined with France, and as a result of the conflict Europe was on the verge of war in the year 1911.

This is financial imperialism. Egypt, Tunis and Morocco are not isolated cases. The Boer War was the result of the exactions and demands of the gold mine owners and the diamond mine owners in South Africa. They wanted to be free from taxes. They desired cheap labor. They fomented local troubles. The great mining syndicates owned or controlled portions of the English press, and finally lured the British government into South Africa to give greater value to the mining concessions and to subdue the natives into willing workers at starvation wages. Germany plundered Turkey and Asia Minor by the same means. She secured the concession for the Bagdad railroad. Her bankers made $25,000,000 in commissions and saved $41,000,000 in construction costs. These, however, were charged against the Turkish government. Germany practically controlled the revenue system of Turkey; and the Deutsche Bank, the representative of German finance, became the real ruler of Turkey and Asia Minor, and reduced that state to a condition of subjection through its many political and financial ramifications.

Financial penetration reduced Roumania and Bulgaria to the same abject subjection to Germany. The Japanese-Russian War, it is now admitted, was largely the result of the clamor of financial interests seeking to exploit Manchuria.

### American Financial Domination of Mexico

All these powers are a unit in their desire for a strong government in Mexico which can be controlled in the interest of the great financiers who own the gold, silver, copper, oil and other mineral resources of the country. They own the railroads, the public service corporations of the cities. They have great plantations. The combined concessions and claims of foreign financiers in Mexico aggregate not less than $3,000,000,000, or about four times the total wealth owned by all the Mexicans of Mexico. Many of these grants and concessions were obtained by bribery and corruption under the Diaz régime. Even the lands of the Mexican people were stolen from them. The people were driven with machine guns from their common lands which they had occupied for centuries, in order to force them to work in the mines at beggarly wages. Mexico was a foreign feudatory owned by foreign financiers who had the backing of their state departments in their support of Diaz and later Huerta, and who are actively interested in the overthrow of Carranza, just as they were in the overthrow of Madero. American concessionaires hold the largest stakes in Mexico. It is a Mexican saying that the capital of Mexico is not Mexico City, it is New York.

### Financial Imperialism Demanding Dollar Diplomacy

It is as a panoply for such offenses as have been committed in Egypt, Tunis, Morocco, Turkey, Asia Minor and China that dollar diplomacy is being insisted on by the great financial interests of America. It demands the backing of the state department, and the use of the diplomatic and consular service. When these fail it demands a great navy to enforce its claims, collect its debts and insure its concessions. Dollar diplomacy means that American sovereignty shall penetrate into weak states, overthrow revolutions and rebellions, and substitute a strong privileged government for a government by the people, if such government by the people insists on the regulation of its own internal affairs for the benefit of the state. The financiers of America are especially insistent because America has now become a great creditor nation. Our banks are bulging with surplus wealth. The resources of the national banks alone are in excess of $14,000,000,000. Interest rates at home are falling. The

Federal Reserve Act is reducing interest still further. Wall Street will not permit domestic investments in the things Wall Street owns, in mines, railroads or the great industrials like sugar, tobacco, the packing industry, wool, cotton, and copper, for investment at home means competition with the things Wall Street owns.

An outlet must be found for the surplus wealth of America. It can only be found overseas. Overseas investments, however, will only be made with the army and the navy as an insurance agency. And this is what the new privilege, the privilege of financial imperialism, is demanding. It is demanding that the United States shall become a partner in the placing of loans with foreign governments; that it shall aid in the securing of concessions and privileges for the building of railroads and the acquisition of mines; that the State Department shall negotiate treaties with other countries securing favored contracts for American financiers coupled with treaty provisions that in case of the failure of the contracting power to live up to its obligations the United States shall be empowered to intervene and see that the terms of the contract are carried out. Dollar diplomacy means entangling international relationships, not on grounds of mutual political interest, not on grounds of advancing the peace and well-being of the world,—dollar diplomacy means that the relations of the United States with the outside world shall be determined by the pecuniary interests of a small group of financiers who now control the credit of the country and whose prospects are menaced by surplus capital seeking investment at home. Dollar diplomacy means not only these things; it means that the country must commit itself to a great navy, to militarism, possibly to universal military service, in order that we may be ready to meet any one of the great powers with which we may come into conflict in the further partition of the world, in the division of which the great powers of Europe have heretofore had an unchallenged monopoly.

# BOOK DEPARTMENT

## GENERAL WORKS IN ECONOMICS

CAHN, HERBERT. *Capital Today.* Pp. x, 313. Price, $1.50. New York: G. P. Putnam's Sons, 1915.

An attempt is made to interpret both the modern centralized control of capital and the recent modifications of the monetary system in the light of Marxian economics. To do this, the author first clears the way by scorning economics as now taught in universities and colleges, placing in lieu of this so-called "controlled economics" the Marxian "Labor Theory of Value" as the only real and scientific basis for economic thought to rest upon.

It is argued that the chief faults of the present economic system are traceable to the fact that some other commodity than labor constitutes the basis of value. This commodity is gold. Seeing that gold has definite quantitative limitations and a qualitative universality the author holds that it possesses the following powers:

First. That it has a scarcity value (which now has become a monopolistic value) antagonistic to labor value.

Second. That gold is a commodity value set up against all other values, and therefore labor, like all other commodity values, must suffer the effects of exchange value with this highly controlled article—gold.

The theory as briefly outlined above is substantiated by a careful study into the recent developments of industrial capital and the monetary system. Everywhere the author finds concentration and central organization taking place, and he sees it pursue its final mission of clearing the way to a higher social order.

The first few chapters impress one that the book is propagating Marxian economics; and, in fact, the definiteness and absolute assurance with which the author accepts Marx's "Surplus Value" and "Labor Theory of Value" cannot help but make the reader feel that the main theme of his book is built upon economic theory which he has accepted with little or no reservation or criticism.

C. R.

CHU, CHIN. *The Tariff Problem in China.* Pp. 191. Price, $1.50. New York: Longmans, Green and Company, Columbia University Studies in History, Economics and Public Law, 1916.

This is a distinct contribution to studies already made by Chinese students in American universities of economic conditions in their country. Dr. Chu presents in detail a view of the tariff in China, its history, underlying traditions and administration. He does not confine himself, however, to this expository task alone; he also capably maintains the theses that:

(1) The low duties are quite inadequate to serve as aids to China's industrial development.

(2) Concessions from the unusually low rates are granted very liberally to foreigners, by treaties discriminating against the Chinese.

(3) The revenue from duties on imports (and on exports) has no logical relation with the fiscal system of the country, since the low duties do not result in any correspondingly large volume of revenue, and the rigidity of the rates keeps the customs revenue from serving to supplement the income of the state.

On the whole, Dr. Chu shows clearly enough that the present Chinese tariff, in the first place, is worse than useless as a protective measure. It renders slight service as a means of revenue. Its administration and modification through treaties discriminate heavily against Chinese traders in favor of foreigners. In short, concludes the author, it is only an instrument for the exploitation of Chinese trade by foreigners, and has been so ever since the Opium War.

A. A. O.

YOUNG, ARTHUR NICHOLS. *The Single Tax Movement in the United States.* Pp. x, 340. Price, $1.50. Princeton: Princeton University Press, 1916.

Few reform movements have made a stronger appeal than has that of the single taxers. The accuracy of many of their contentions and their enthusiasm has deeply influenced modern economists. Their emphasis on many of the injustices in private ownership of land has helped to concentrate attention on the need for reform. The effects have been far reaching. Even though no community has yet been able to apply the single tax theory in an unqualified manner there have been noteworthy results in several directions. Although other influences are in part responsible, present-day emphasis on the exemption of improvements, on taxation of the unearned increment and on other modern reforms is in part due also to the single tax movement.

An unprejudiced history of such a movement has been needed and fortunately is now at hand in this volume by Dr. Young. Although there were many anticipations of the doctrine among the early economists, the modern movement originates with Henry George. The economic life of California and its effect on George's views, the appearance of *Progress and Poverty* and his other works, and his participation in politics are described in detail. The movement after the death of George is traced in the different states and the tactics of the single taxers is analyzed.

The volume is scholarly throughout and its style is pleasing. Although the narrative requires careful attention to details, the accuracy of which is vouched for by voluminous references, it is readable from beginning to end. The author finds it impossible even in his narrative to conceal entirely his lack of sympathy with George's doctrine but nowhere does this difference of opinion become so pronounced as to prejudice the conclusions.

Little is said regarding the nature of the single tax and the validity of the argument until at the end of the volume where the last chapter treats of some of the theoretical aspects. This discussion is not entirely satisfactory. Perhaps because of space limitations only a part of the theoretical contentions of George and his followers are considered and answered. This is, however, a minor objection to a volume that is intended to be primarily narrative. It is a most welcome and valuable study.

E. M. PATTERSON.

*University of Pennsylvania.*

## AGRICULTURE, MINING, FORESTRY AND FISHERIES

CARVER, T. N. *Selected Readings in Rural Economics.* Pp. viii, 974. Price, $2.80. Boston: Ginn and Company, 1916.

Issued as another of the well-known series of *Selections and Documents in Economics,* this volume presents in convenient form a collection of material on rural economics, drawn from widely diverse sources. As the author states in his Preface, it "is not intended to take the place of any of the manuals that are now available on the general subject of rural economy. . . . ." In other words, this volume is compiled mainly for the purpose of making available under one cover numerous articles which would otherwise be difficult for the student to reach, rather than with the aim of collecting all the best available material on the subjects treated. The book is divided into eight parts, with selections bearing on General Principles, Agricultural History, Land Tenure, Agricultural Labor, The Farmer's Business, Agrarian Movements in the United States, Rural Organization and Marketing, and Agricultural Policy.

L. D. H. W.

LEAKE, ALBERT. *Means and Methods of Agricultural Education.* Pp. xxiii, 273. Price, $2.00. Boston: Houghton, Mifflin Company, 1915.

Man's chief job, after meeting the immediate needs of food and shelter, is to become adjusted to his environment. Few realize how big a job this is for those responsible for the making of curricula for the common schools of America. One gets some glimpses of this fact as he reads in Mr. Leake's book. He also appreciates the impossibility of getting a good school with the unit of organization now in such general use. The book is a good survey and shows clearly a lot of our needs and the way out.

J. R. S.

WILLIS, J. C. *Agriculture in the Tropics.* (2d Ed., rev.). Pp. xvi, 223. Price, $2.25. New York: G. P. Putnam's Sons.

This revision of this valuable treatise on tropical agriculture has been slight, consisting for the most part of minor changes in detail. First appearing in 1909, the book is today probably the best brief treatment of the subject it discusses. Part I is a discussion of the preliminaries to agriculture, treating of land, soil, climate, population, transport, plant acclimatisation, etc. Part II, comprising nearly one half of the book, is descriptive of the principal cultivations of the tropics and Part III gives an account of agricultural conditions, discussing the nature and conditions of peasant or village agriculture as compared with capitalist or estate agriculture. The book ends with a plan for agricultural organization and policy in tropic countries.

G. B. R.

## MANUFACTURING INDUSTRY

ALLEN, FREDERICK J. *The Shoe Industry.* Pp. 327. Price, $1.25. Boston: The Vocation Bureau of Boston, 1916.

This book briefly traces the history of the shoe industry from hand labor to machine operation, touches upon the art of tanning, sets forth the general divisions of the manufacture of leather footwear, and then minutely describes the manufacturing operations incident to the production of shoes. The particular jobs in each department are fully explained and their return indicated. The book contains, moreover, an excellent glossary of terms used in shoemaking, a short list of representative books that may be used for reference and a full catalogue of shoe periodicals.

The purpose of the volume is to furnish to young people about to choose an avocation the complete details of the opportunities in the shoe trades, an aim which is thoroughly accomplished by the author. A carping critic might question Mr. Allen's ability as a historian or his sensitiveness to economic factors of cause and result, but no one could find fault with his painstaking account of the processes of shoe manufacture and the consequent demands for workers. Not only young men and women seeking vocational guidance, but everyone connected with the shoe business, particularly salesmen and retailers, will find this treatise helpful.

M. K.

GOWIN, ENOCH BURTON. *The Executive and His Control of Men.* Pp. xv, 349. Price, $1.50. New York: The Macmillan Company, 1915.

This book is an analysis of the sources and methods of the power of an efficient, dominating executive. How and why does this man rise to leadership among the other nine hundred and ninety-nine with whom he contended? Dr. Gowin answers this question in a twenty-four chapter book, divided into three parts as follows:

Part I. Individuality.
Part II. Motivating the Group.
Part III. Limits upon the Executive.

The study is, in the main, a theoretical explanation of the power of the dominant manager from the standpoint of psychology and sociology. Quotations and references from standard works on sociology and psychology occupy considerable space. Aptly chosen historical references *ad libitum* illustrate specific points with the experience and practice of the leaders of the world's affairs. An interesting and amusing comparative statistical analysis of the physical characteristics of the various grades of executives is included.

The book is carefully prepared, ably analyzed, and well-written. A prodigiously broad reading and observation have preceded writing. One can but wonder, however, whether a study so broadly academic in character, one which will appeal to the philosophical mind, will be sufficiently specific to interest the executive,—he of the motor type, whose power is to him an unanalyzed art.

J. H. W.

PROFIT SHARING BY AMERICAN EMPLOYERS. Pp. 261. Price, $2.00. New York: Welfare Department, The National Civic Federation, 1916.

During recent years numerous attempts have been made by employers to establish schemes whereby "employes would receive some share in the earnings of the business in addition to their fixed regular wages. . . . . These wage additions have been indiscriminately termed 'profit sharing' and they have been regarded by many employers and a few eminent students of industrial tendencies as forecasting a final 'solution of the labor problem.'"

"Because of the desire of many employers for exact information on the workings of these plans, and public interest in the claims made for profit sharing as a general remedy for labor difficulties, The Welfare Department of the National Civic Federation has made an extensive investigation and analysis of more than 200 plans in the United States, embodying the idea in one form or another of extra payments to labor."

The analysis of each of these plans is given in brief and discloses three main types of "profit-sharing" plans as follows:

"1. Percentage of profit plan
2. Special distributions or gratuities
3. Stock ownership plan"

This comprehensive and complete survey of employers' experience in profit sharing shows them to be not at all agreed in the approving of it as a means of increasing efficiency and improving industrial relationships. The study contains the opinions in considerable detail of many of the leaders of organized labor. These opinions are almost unanimously opposed to the principle of profit sharing.

This study is open to all the criticisms that the questionnaire method of studying a problem is subject. It is primarily a second-hand expression of employers' opinion, supplemented by more opinion by the representatives of organized labor,—not the opinion necessarily of those who actually worked under the particular system in question. It may properly be asked whether more intensive first-hand studies in a few of the plants where more successful profit-sharing system had been installed might not have revealed more about "profit sharing as a solution to the labor problem" than such a broad second-hand survey.

JOSEPH H. WILLITS.

*University of Pennsylvania.*

## COMMERCE AND TRANSPORTATION

BROWN, HARRY GUNNISON. *Transportation Rates and Their Regulation.* Pp. xii, 347. Price, $1.50. New York: The Macmillan Company, 1916.

This work presents a complete theory of transportation rates and their regulation. Starting with the general assumptions that traffic receipts as a whole must cover the entire cost of transportation, yielding a fair return on actual investment, and that each item of traffic must pay a rate high enough to cover the additional expenditure which it occasions, the author shows how the influence of conditions of monopoly and competition in the transportation business causes charges to have widely varying relations to the cost of the service, and discusses

in detail the economic justice or injustice of the various forms of discrimination in transportation rates. A brief history of the development of rate regulation in the United States is given and this is followed by a searching analysis of principles followed by the Interstate Commerce Commission in their work of determining what constitutes reasonable rates under varying circumstances. The final chapter deals with the general question of government interference with, and encouragement of, transportation.

While presenting little that is new concerning the general problem of transportation charges, Professor Brown has performed a service in bringing together in compact form and presenting in a concrete manner the several phases of the problem, and moreover he makes a distinct contribution to the literature of the subject by applying to all phases of the problem the test of "economy" from a national standpoint. He does not for an instant lose sight of the fact that he is proposing a general *theory* of transportation charges, and the touchstone of validity of his conclusions is the result of their application upon the welfare of the public,—"public" including not only those who are served by transportation agencies, but the transportation agencies as well. His frank and able criticism of "government coddling" of private business by subsidies and other forms of "protection" is a timely contribution.

T. W. V. M.

FERGUSON, MAXWELL. *State Regulation of Railroads in the South.* Pp. 228. Price, $1.75. New York: Columbia University Press, 1916.

An historical account of the development of railroad regulation in the Southern States. Though the present system of regulation shows a marked improvement over conditions a few years ago, the author feels, in common with nearly all other students of transportation, that because of the inherent weaknesses of railroad regulation by states and the ever growing problem of conflict between state and federal regulation, the supervision of the railroad business by the states should be supplanted and the work be entrusted for the most part to the federal government.

T. W. V. M.

## LABOR PROBLEMS

FRANKFURTER, FELIX, assisted by GOLDMARK, JOSEPHINE. *The Case for the Shorter Work Day; Brief for Defendant in Error. (Franklin O. Bunting vs. The State of Oregon.)* Pp. xv, 1021. (2 vols.) New York: National Consumers' League, 1916.

This brief represents the defense in the case recently argued before the Supreme Court of the United States limiting the hours of labor to ten in one day. It follows the line of argument in similar cases, presenting the literature of fatigue and dealing with the physical, economic and social aspects of regulation. The brief was prepared under the direction of Louis D. Brandeis, but was argued by Professor Frankfurter because of the appointment of the former to the Supreme Court Bench. The argument was contributed by Professor Frankfurter. This case is the first in which the statute under review has included the work of men.

A. F.

GROAT, GEORGE G. *An Introduction to the Study of Organized Labor in America.* Pp. xv, 494. Price, $1.75. New York: The Macmillan Company, 1916.

There has been a serious gap in the literature of the labor movement. There was no comprehensive study that was impartial and sought to present two sides. Professor Groat has attempted to fill this need. He has sought to present the background and present activity of the labor movement by quotations from representative opinion of all sorts.

The study is divided into six parts: The Background, The Structure, Collective Bargaining, Political Activity, Transitional Stages and Conclusion.

In his preface the author defends the restriction of his study to organized labor by stating that the study would have been too long if other matter had been included. It would seem to the reader that it would have been more valuable, however, if a summary of the relation of Socialism, for example, had been inserted in the place of some of the detailed statistics on trade union strength and strikes and lockouts that find a place. This fact is especially important when it is considered that the volume is intended primarily for use in college classes.

Except for a short introductory note of suggestions for further reading, there is no citation of sources. This seems unfortunate. If further reading in the subject is to be encouraged, a detail-bibliography would have been of assistance even if it were deemed inadvisable to incorporate the references as footnotes.

One other criticism should be presented. Until the conclusion is reached, one does not feel the humanness of the labor movement. The author in his evident attempt to be fair and to present all sides, seems to lean backward. One is not made to feel that each development of unionism has been the attempt to right a wrong or an imagined unfairness.

In spite of these faults of method, the book stands out as a valuable contribution that should do much to make the employes' attitude comprehensible to employers and the latter's approach clearer to the worker. If it can do this it will have served a useful purpose, even if its group of readers is small. It should also serve as a useful text-book in the colleges that have courses in the labor movement.

ALEXANDER FLEISHER.

*New York.*

## MONEY, BANKING AND FINANCE

HEPBURN, A. BARTON. *A History of Currency in the United States.* Pp. xv, 552. Price, $2.50. New York: The Macmillan Company, 1915.

This book is a revision of the author's *The Contest for Sound Money,* published in 1903. The earlier work has been rewritten and supplemented so that it now covers the entire national period and contains some introductory material on the colonial period.

Notwithstanding its title, the book is more than a currency history. In fact, its most valuable part is the treatment of the national banking system and of recent developments under the Federal Reserve Law. Of this more recent

period Mr. Hepburn speaks with much first-hand knowledge gained during his long, varied and honorable career in American finance, during which he has held the positions of Superintendent of Banking in the State of New York, Comptroller of the Currency, President of the New York Clearing House, Chairman of the Board of Directors of the Chase National Bank, and Chairman of the Currency Committee of the American Bankers' Association.

The earlier part of the book is based largely upon secondary sources and a few of the better known public documents. The discussion contains little that is new, and the treatment is more that of a well-balanced narrative than of a critical analysis of American currency history. The author refers to his book as "a busy man's library."

E. W. K.

SCOTT, WILLIAM A. *Money and Banking.* (5th Ed.) Pp. ix, 406. Price, $2.00. New York: Henry Holt and Company, 1916.

In this edition the author has made a few changes, especially by adding a section to Chapter X where a number of pages are devoted to a discussion of the federal reserve system.

E. M. P.

## POLITICAL AND GOVERNMENTAL PROBLEMS

ALEXANDER, DE ALVA STANWOOD. *History and Procedure of the House of Representatives.* Pp. xv, 435. Price, $2.00. Boston: Houghton, Mifflin Company, 1916.

A brief yet comprehensive treatment of the history and present status of procedure in the House of Representatives by one who speaks with authority so far has been lacking. This lack has been felt especially by many a teacher desiring to acquaint his students more intimately with that important phase of practical politics. This need is well filled by the present volume, written by one who himself was a member of Congress for fourteen years. The scope of the volume can best be briefly indicated by a statement of the eighteen chapter headings: Apportionment and Qualification of Members; The Roll of Members Elect; Organization of the House; The Speaker; The Speaker and Committee Appointments; Other Officers and the Whip; Floor Leaders; Privileges, Pay, and Obsequies of Members; Creating and Counting a Quorum; The Rules and the Committee on Rules; The Order of Business; Committees and their Work; The Committee of the Whole; The Making of a Law; Debate and Debaters; Contested Election Cases; Impeachment Proceedings; The President and the House.

An appendix of twenty-five pages adds interest to the book by giving the names of former speakers, clerks, and other officers of the House and other personal and political data.

H. G. J.

GOODNOW, FRANK J. *Principles of Constitutional Government.* Pp. 396. Price, $2.00. New York: Harper and Brothers, 1916.

KRÜGER, FRITZ-KONRAD. *Government and Politics of the German Empire.* Pp. xi, 340. Price, $1.20. New York: World Book Company, 1915.

This handbook, the first in its series, is an excellent product of the bookmaking art, both as to authorship and craftsmanship.

As this work covers much the same field as *The German Empire* by Howard and as the order of chapters is strikingly similar, it may be profitable to compare the two works. Of course the handbook is much the smaller. Howard restricts himself to strictly legal and institutional questions; Krüger reaches into topics which give color and action to his story, such as the physical basis of the German Empire, the present-day methods of transportation and communication, the parliamentary history of the country, Germany's foreign policy since 1871, and the colonial dependencies. Howard gives a closely integrated and impartial treatise upon Germany, but Krüger gives a somewhat scrappy and frankly pro-German account of the country which he calls "Prussia-Germany" (p. 157), which he declares "now demands a place in the sun" and the diplomacy of which "cannot restrict itself for the future to defense."

Though Dr. Krüger excuses the aggressions of Prussia by appeal to the precedent of the colonists in the United States expelling the Indians by force from their territory, a pitiable argument since the Indians were but small bands of savages in a practically vacant continent, yet in general he puts a proper scientific restraint upon himself. For example, he considers that the Germans are too pronouncedly conservative (p. 11), that the Emperor is dangerously impulsive (p. 92), and that the bureaucratic administration of the colonies was till "Dernburg cleansed the Augean Stables" scandalous, and the progress since has been slow with many bad mistakes (pp. 267, 8).

Minor inaccuracies and omissions may be noted. The term "delegates" is used for delegations (p. 67). No mention is made of the secrecy of the meetings of the Bundesrat. The reader is mystified by the explanation of the responsibility of the Chancellor (p. 78), whereas the explanations of Lowell and Ogg are lucid and satisfactory. The main objection of the reviewer is that Dr. Krüger has conceived of the German government as a finality which is to be defended rather than as a stage in evolution which is simply to be explained, and that he advocates militarism for Germany and its policy of aggression with no recognition of the principle of nationality, or of consent of the governed, or of the sacredness of treaty obligations, or of the possibility of international confederation.

C. H. MAXSON.

*University of Pennsylvania.*

MACY, JESSE and GANNAWAY, JOHN W. *Comparative Free Government.* Pp. xviii, 754. Price, $2.25. New York: The Macmillan Company, 1915.

This book is a distinct contribution to the study of comparative government in that it brings within the compass of seven hundred pages an attractive presentation not only of our own government but of the leading democracies of the world. Nearly four-sevenths of the space is devoted to the United States and the balance is given to foreign states. For those students whose special courses place severe limitations upon their power of election this text-book may be regarded as

a very successful solution of the problem of combining the study of our government with foreign governments in a single year. Furthermore, as an initial course in Political Science the comparison of the presidential system with the parliamentary system may prove illuminating to many students.

The emphasis being laid upon free government, a meager allotment of twenty-two pages is given to the delineation of the institutions of the German Empire. Yet as democracies must acquire the art of effective administration to justify their form of government and even to perpetuate it, the lessons of German administration and university coöperation might well have larger recognition. The authors round out their survey of free government by devoting thirty-three pages to South America, a happily conceived concession to the progress of the A. B. C. states and our rising interest in Latin America.

Our authors are to be commended for cutting short their theoretical discussion of the puzzling question of sovereignty. Better had they cut the question out entirely, unless they abandoned the "made in Germany" doctrine of indivisible sovereignty and accepted the theory of the American and Swiss constitutions that sovereignty is divisible and is actually divided. The Swiss Constitution says "the Cantons are sovereign so far as their sovereignty is not limited by the Federal Constitution." Our Federal Constitution as interpreted by the courts is identical in this respect with the Swiss, though the document itself does not employ the term. Darwin P. Kingsley says that "unconditioned sovereignty was the fundamental error in the civilization of 1914." General Carranza seems to be obsessed by the same mad notion which the Political Scientists have taught him. Is it not truer to facts and ideals to say that sovereignty is divisible and that a state may attain power and prestige by surrender of part of its sovereignty to the sisterhood of states? This applies to our commonwealths in relation to the union and it applies to our nation in relation to a proposed international union.

The book under review is distinctly readable and evidences the authors' splendid grasp of the subject matter. The book ought to win a useful place in the teaching of comparative government.

C. H. MAXSON.

*University of Pennsylvania.*

TAFT, WM. HOWARD. *The Presidency: Its Duties, Its Powers, Its Opportunities and Its Limitations.* Pp. v, 145. Price, $1.00. New York: Charles Scribner's Sons, 1916.

TAFT, WM. HOWARD. *Our Chief Magistrate and His Powers.* Pp. 165. Price, $1.50. New York: Columbia University Press, 1916.

The first of these two volumes on the presidency by former-President Taft consists of three lectures delivered at the University of Virginia in 1915; the second, of a series of six lectures given at Columbia University one year later. Both volumes cover, therefore, the same ground and follow a similar arrangement and treatment, in some cases the phraseology of considerable portions being identical. After a general introduction dealing with the distribution of governmental powers and the place of the executive in our constitutional system, the powers of

the president are discussed in the following order: the veto power, executive relations with Congress, Cabinet, and Commissions, the power of appointment, the supervision of the execution of laws, the president as commander-in-chief, executive power in foreign relations, the pardoning power. A final chapter discusses the limitations on the president's power, chief among which are noted restraints imposed by Congress, the supreme court, and custom. The view that the president possesses an undefined residuum of power and the policies of former President Roosevelt in his exercise of such powers are severely criticized. Especially interesting is the chapter on the appointing power, in which the evils of the present system of dispensing patronage, as well as certain defects in the civil-service system are clearly brought out. Coming from one who has had practical experience in the things whereof he speaks, these lectures are more than usually valuable to the student of public affairs.

R. G. G.

## INTERNATIONAL QUESTIONS

COLBY, FRANK MOORE (Ed.). *The New International Year Book for 1915.* Pp. 752. Price, $5.00. New York: Dodd, Mead and Company, 1916.

Desirous of knowing at a glance who headed the National League batting list in 1915, what relation eugenics has to the war, what States passed "blue-sky" laws, what was the status of world trade and industry, what were the developments of feminism, philology, or meteorology during the past year, one may comfortably take from his desk *The New International Year Book.* Whatever the subject, he may be reasonably sure of finding it treated, and the general acceptance of this annual cyclopedia, since 1907, gives it a certain authority.

The ground covered by the Year Book takes from its value as a source book for specialized study; it is, however, an important hand book of recent events and contains valuable current bibliographies, statistics and biographies. The arrangement of material has been altered only in that certain statistical information—unavailable because of the war—has been replaced by a "comprehensive article on the WAR OF THE NATIONS," and this lead article may be said to defy the multiplicity of events and confusion of reports in an effort to give a clear, connected, impartial account of what has been happening in this almost overwhelming field.

C. H. C.

CRANDALL, SAMUEL B. *Treaties, Their Making and Enforcement.* (2d Ed.) Pp. xxxii, 663. Price, $6.00. Washington: John Byrne and Company, 1916.

Dr. Crandall has so much enlarged the first edition of his work that it might well be considered as a distinct treatise on the subject of treaties—nevertheless it has been designated as a second edition, and as such supplements the first edition with a wealth of material. The subject of international treaties is particularly interesting because it touches upon some of the most important questions in the whole field of international relations as well as of constitutional law. It would be difficult to find anyone more competent to treat the subject than Dr.

Crandall, who is a member of the bar of New York and the District of Columbia and a thorough student of international law. He has had the additional advantage of practical experience relative to our treaty relations while working in the Department of State.

As regards its arrangement and subject matter, the book is practical, scholarly, and comprehensive. Dr. Crandall makes use of copious citations from European and American authorities. It might perhaps be questioned whether we have not reached the period when we may discard the unimportant comments of many of the men of second-rate ability whose statements he thus honors. Dr. Crandall himself could speak with much greater authority, and this clothing of his own thoughts in the words of some judge of inferior capacity unnecessarily cramps the study of the question. A citation from an unimportant source is apt to encourage the student in a waste of time in searching out the original case. Separate compilations of extracts from judicial decisions, skilfully classified, can be placed in a separate appendix to justify the conclusions reached, but let us break with a method which savors of scholasticism. This very defect will render the book more acceptable to certain of our lawyers who can only receive ideas dressed in such a form. Dr. Crandall is very cautious also about giving us the benefit of his learning. He avoids an application of principles to the important questions of treaty violations which have absorbed so much attention in the last few months, but his conservative discussion throws light on the whole field of international treaty relations and makes of his book an authoritative treatise which every student of international relations and every diplomat must have under his hand.

E. C. STOWELL.

*Columbia University.*

HART, ALBERT BUSHNELL. *The Monroe Doctrine: an Interpretation.* Pp. xiv, 445. Price, $1.75. Boston: Little, Brown and Company, 1915.

HULL, WILLIAM I. *The Monroe Doctrine: National or International?* Pp. ix, 136. Price, 75 cents. New York: G. P. Putnam's Sons, 1915.

Professor Hart's book is the most comprehensive analysis of the Monroe Doctrine with the possible exception of the German work of Kraus. In the first three parts he not only traces the modifications which the Doctrine has suffered at the hands of successive Presidents, but gives a most excellent presentation of the changing attitude of Europe and of Latin America. In Part IV he proceeds to subject to the same critical analysis some of the cognate doctrines, such as the Drago Doctrine, the Calvo Doctrine, the German Doctrine, and the principles of national policy involved in our position in the Pacific. Part V is devoted to an examination of present world conditions with a view to ascertaining whether territorial and commercial relations have so changed as to call for a restatement of the Doctrine. In Part VI the author develops what he calls the Doctrine of Permanent Interest, which in his view presents the most concise formulation of the basic principles of American foreign policy. He adopts this formulation because it emphasizes the vital interest of the United States in all distinctively American questions, and at the same time avoids giving offence, which the use of the term "Paramount Interest" would be certain to give throughout Latin America. The

author points out with great clearness and force that the Monroe Doctrine embodies little more than a defensive principle, the counterpart of which is to be found in other parts of the world, notably the Near East and Eastern Asia.

In the author's view, the Monroe Doctrine is likely to be put to a severe test by some ambitious military power as a direct result of the Great War, unless "Europe is about to enter on a new régime of international understanding and good will." In order to maintain it the United States will be compelled to embark upon a rational naval and military policy which will place the country in a position to defend the Doctrine.

Briefly stated, the author's viewpoint is that the Monroe Doctrine embodies a principle essential to our national safety. Whether we designate it as the Monroe Doctrine or by some other name, it must necessarily form a part of our national policy.

Professor Hart has placed both the general reader and the special student under obligations for this admirable analysis, which will serve to clarify national thought on this perplexing and elusive problem. The value of the work is greatly enhanced by the inclusion of a most excellent bibliography.

The little book by Dr. Hull contains a series of three addresses; one on the Monroe Doctrine, delivered before the Fourth National Conference of the American Society for the Judicial Settlement of International Disputes, a second on a series of proposed solutions, delivered at the Eighth Annual Meeting of the American Society of International Law, and the third on the Hague solution, delivered at the Twentieth Annual Meeting of the Lake Mohonk Conference. The main thesis of the three addresses is a plea for the abandonment of Pan-Americanism for the broader internationalism of a world court of arbitral justice. The author emphasizes the distrust that has been engendered, particularly in the countries of Latin America, by reason of the assumption of what the author regards as a kind of tutelage over the Latin-American republics. His criticism of the Monroe Doctrine is quite temperate but one can readily see that while he has no objection to the Monroe Doctrine in its original form he is evidently fearful of the broad interpretation given the Doctrine by successive Secretaries of State. Dr. Hull's work is the clearest presentation we have as yet had of the point of view of world internationalism as distinguished from the Pan-American point of view.

L. S. ROWE.

*University of Pennsylvania.*

SHERRILL, CHARLES H. *Modernizing the Monroe Doctrine.* Pp. xiii, 202. Price, $1.25. Boston: Houghton, Mifflin Company, 1916.

President Nicholas Murray Butler, in an introductory note to this volume, calls it "a vigorous and stimulating discussion of some of the most interesting and most important questions that now confront the American people." And indeed such it may properly be called. It is novel and radical in some of its proposals, but the two fundamental ideas running through the work—adherence to the Monroe Doctrine, modernized by coöperation with the South American republics, and a vigorous Pan-American policy—command attention. A part of the

work is devoted to showing the importance of South America, politically and commercially. This fact established, the author urges the United States to adopt a policy which would cultivate a better understanding with the southern republics, and which would refrain from interference in European and Asian affairs; on the other hand, our trans-oceanic policy should be directed to exclude all foreign control from every part of this hemisphere. The Philippines should be traded, if necessary, to secure isolation of this hemisphere, Japan should be assured that we do not intend to control in any way the destiny of China, the three foreign powers now holding possessions in South America should be ousted, and even our treaty with England regarding the Panama Canal should be broken at the first opportunity to give us complete control. Such a policy would strengthen the Monroe Doctrine, enable us to form a Pan-American Union to the mutual advantage of all the Western republics as well as the rest of the world.

K. F. G.

STOWELL, ELLERY C. and MUNRO, HENRY F. *International Cases.* Vol. I. *Peace.* Pp. xxxvi, 496. Price, $2.50. Boston: Houghton, Mifflin Company, 1916.

Although there is undoubted need of collections of international cases, the difficulties in the way of making a collection sufficient for all classroom purposes seem insuperable. For an adequate illustration of even the more important topics of international law many volumes would be required.

Probably the experienced teacher will prefer to make his own selection of cases adapted to the needs of his particular class, prescribe in conjunction the best text-book he can find, and assign such cases as he deems most useful and available. By filling the library shelves with duplicates of Moore's Digest, Scott's Cases, and other leading authorities and collections on International Law, he will have a good working library.

To such a collection, this volume will prove a most valuable, indeed, an indispensable addition. The cases are carefully selected and well edited. They include judicial decisions, cases of arbitration, and numerous cases or instances drawn from negotiation or the diplomatic practice of nations. Of the latter there have hitherto been too few in accessible form. Perhaps the stickler for judicial cases will find that this volume contains too few of his old favorites. But the student of arbitration and negotiation will be pleased to find so much new and fresh material.

A. H.

*Indiana University.*

## MISCELLANEOUS

WILLSON, BECKLES. *The Life of Lord Strathcona and Mount Royal.* (2 vols.) Pp. xi, 1057. Price, $6.50. Boston: Houghton, Mifflin Company, 1915.

Based upon the papers of Lord Strathcona, the archives of the Hudson's Bay Company and official correspondence for a period of approximately twenty years, these volumes give a very suggestive and intimate portrayal of the discussion and

settlement of some of the most important issues of the Dominion of Canada in the eventful forty years which have just closed. By a very extensive use of quotations from personal letters and public documents, Mr. Willson describes the enlistment of Donald Smith, afterwards Lord Strathcona, in the service of the Hudson's Bay Company as junior clerk, and his advancement by extraordinary perseverance and exceptional ability to chief factor of the company. An account is given of his gradual rise into prominence in the affairs of the Dominion. His connection with the Canadian Pacific Railway, his service as High Commissioner for Canada at London and his interest among other matters in such important dominion affairs as public education, charitable institutions and Canadian immigration are exhaustively treated.

The author has not attempted to prepare a critical biography and his indiscriminate commendation of Lord Strathcona as well as his extensive use of irrelevant correspondence detract somewhat from the usefulness of the work. Despite these limitations the biography constitutes a notable record of one of the greatest characters in Canadian history.

C. G. H.

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